

MASS. SA1.2: S29/5/v.2

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State Auditor's Report and Recommendations for the Reform of the Commonwealth's Purchase-of-Service System for its Social and Human Service Programs

Comprehensive Statewide Review of the
Administrative and Accounting Controls Established
by the Division of Purchased Services

VOLUME II
NO. 93-4001-3

GOVERNMENT DOCUMENTS
COLLECTION

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Commonwealth of Massachusetts

Office of the State Auditor
A. Joseph DeNucci, Auditor

OFFICIAL AUDIT REPORT

DECEMBER 14, 1994

TABLE OF CONTENTS/EXECUTIVE SUMMARY

Page

INTRODUCTION

1

The amount of social services the state purchases through its purchase-of-service (POS) system has dramatically increased over the past two decades from approximately \$25 million in 1971 to over \$1.6 billion during fiscal year 1993. In order to effectively oversee this system, during fiscal year 1991 the Legislature established within the state's Department of Procurement and General Services, but not subject to its control, a Division of Purchased Services (DPS). Currently, DPS has system-wide responsibility for implementing and coordinating an efficient and accountable system of procurement, selection, pricing, contract administration, program monitoring and evaluation, contract compliance, and post audit for any state agency that procures or pays for social services programs from contracted service providers. State agencies that procure POS-related services as well as contracted service providers are required to comply with all applicable DPS regulations and guidelines.

The objective of our review was to analyze certain administrative and accounting controls DPS had established and implemented relative to the operation of the POS system and, where necessary, to recommend how to improve these controls. Through the establishment and implementation of an adequate internal control environment, DPS should be able to better administer the POS system in the most efficient and effective manner. In order to meet this objective, we conducted audits of five state agencies--the Department of Youth Services (DYS), the Department of Social Services (DSS), the Department of Correction (DOC), the Department of Mental Retardation (DMR), and the Department of Mental Health (DMH) and 40 social service providers that were awarded contracts by these agencies. During fiscal year 1993, these five state agencies expended over \$988 million on POS-related services, which represented approximately 61% of the state's total POS expenditures for this fiscal year. Additionally, these 40 service providers received state contract awards in excess of \$91 million during this fiscal year.

Our reviews identified 16 significant systemic, regulatory, and operational deficiencies at the state-agency level within the POS system and over 130 deficiencies, involving over \$19 million in state funds, at the 40 service providers we audited. These deficiencies were primarily the result of inadequate internal controls within the POS system that were causing the system to operate at less than optimum level and, in some instances, to be abused.

In summary, our review of this system indicated that the system is being inadequately administered and regulated and poorly monitored. For example, we found that the POS system is a more than \$1.6 billion system that allows state agencies to:

- o Procure services from contracted service providers without adequately assessing and/or documenting service needs.
- o Employ dysfunctional and ineffective budgeting practices and agree to rates of payment without sufficient budgetary detail and properly trained staff to ensure that program budgets are equitable and reasonable.
- o Award and renew contracts with service providers with little or no competition.

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

- o Inadequately monitor service providers and program services.
- o Not maintain accurate inventories of the millions of dollars in furnishings and equipment items they provide to service providers with state funds.

In addition, other regulatory and operational problems exist within the system that facilitate conditions of waste, abuse, and illegal costs.

In response to our audits, DPS has taken measures to address some of the regulatory concerns raised during our audits of service providers (a description of our specific concerns, examples of some of the problems we found during our audits of service providers, and DPS actions relative to these concerns appear in the Regulatory Deficiencies Section of this report). However, there are still significant problems within the POS system that warrant immediate attention and action by DPS and the state Legislature. These problems are as discussed in the Audit Results section of this report.

AUDIT RESULTS 13

SYSTEMIC PROBLEMS AT THE STATE AGENCY LEVEL 13

1. Inadequate Monitoring and Evaluation of POS Services Results in Inadequate Assurance That: All of the over \$1.6 Billion Spent on These Services is Expended in Accordance with the Terms and Conditions of State Contracts and Applicable Laws, Rules, and Regulations; Services Are Being Delivered in the Most Effective and Efficient Manner; the Desired Objectives Are Being Accomplished: 13
 DPS has delegated the responsibility of establishing and implementing POS-related monitoring and evaluation policies and procedures to the state purchasing agencies. In the absence of any specific guidance from DPS, we found the monitoring and evaluation activities being performed by the five state agencies to be deficient. For example, none of the five state agencies formally appointed a contract performance manager as required by DPS regulations to monitor each provider's compliance with all the terms of their state contracts, nor have any of these agencies developed and implemented formal written policies and procedures relative to the monitoring and evaluation of program services that correlate program inputs (funding) to processes (program structure) and program outcomes (desired results) to determine whether programs are operating in the most effective and efficient manner. In effect, no statewide "system" of monitoring and evaluation exists (i.e., an overall established flow of information from the point of service up through management relative to service provider activities) that is utilized by management to make program decisions or to assess the performance of service providers. Rather, the monitoring and evaluation activities being performed by these state agencies were fragmented. Fiscal and programmatic activities being conducted by state agencies were not being coordinated; monitoring activities were not being routinely conducted; and any information being gathered was not being synthesized and used effectively to evaluate program services or the performance of service providers. Also, our audit revealed that, although service providers are required to submit an abundance of information relative to their activities, this information in some ways is deficient (see Other Issues No. 2), and in many cases is not being used to effectively monitor and evaluate their contracted service providers.

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

For example, although DPS requires contracted social service providers to annually submit comprehensive Uniform Financial Statements and Independent Auditor's Reports (UFR), DPS does not have the staff to effectively analyze this information. In fact, according to DPS officials, less than 10% of the approximately 900 full UFRs submitted to it during fiscal year 1993 received a desk review by DPS, and only one of these UFRs received a quality control review. Because POS expenditures are not being adequately monitored and program services and service providers are not being adequately evaluated, the Commonwealth cannot be assured that all of the over \$1.6 billion it spends annually on POS services is being spent in accordance with the terms and conditions of state contracts and all applicable laws, rules, and regulations, nor can it be assured that program services are being delivered in the most effective and efficient manner, or that expenditures for these services are accomplishing the desired results and objectives.

2. **Inadequate Program Budget Negotiation and Budget Monitoring Activities by State Agencies Resulting in a Lack of Assurance That Social Service Programs Are Being Properly Funded and Administered:** We found significant problems with the contract negotiation/budgeting and contract renewal process used by state agencies in funding their POS contracts. Specifically, none of the five state agencies had developed and implemented standard policies and procedures relative to contract negotiations nor were they conducting regular formal training programs relative to prudent contract budgeting practices. Also, program budgets are dysfunctional in that they are used by state agencies only to establish the unit rates of reimbursement for program services and not to plan, monitor, and evaluate program costs or services. Several social service providers we audited criticized the contract budgeting process, stating that they were given a bottom line contract figure by their state purchasing agency and told to back into this figure with a program budget. These types of budgeting practices can result in the state's inequitably funding program services and may cause a highly unstable financial environment within the POS system. Also, these practices serve as a disincentive for providers to improve program models, when the state purchasing agency is holding them to the same level of funding. In fact, we found that the POS provider system may be experiencing financial deterioration as a result of these budgeting practices. For example, according to data provided to members of the Legislature by the Executive Office of Health and Human Services (EOHHS) in May 1990, the median return-on-asset rate and surplus revenue percentage for the nonprofit organizations for which EOHHS had data was, during fiscal year 1989, 6.6% and 2.7%, respectively. Based on data maintained by EOHHS for fiscal year 1993, the median return-on-asset rate and surplus revenue percentage fell to 3.2% and 1.3%, respectively. In contrast, ineffective budget monitoring and negotiation practices may be providing some providers with excessive funds. For example, one for-profit service provider we audited told us that they realized profits by requesting and receiving funding from DMR for levels of services that they believed to be "optimal" (i.e., costs that the service provider believed could potentially be incurred in the program based on a worst-case situation), but not necessarily what the service provider actually expected to be incurred based on the program's historical costs. These optimal costs would represent the maximum levels of both direct and indirect costs that the service provider believed will be incurred in the program. If the provider did not experience a worst-case situation, this type of budgeting would allow the

25

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

provider to realize unbudgeted profits. As a result, between fiscal years 1988 and 1993, this service provider received approximately \$1.3 million in unbudgeted profits from its state contracts that it retained, a significant portion of which (over \$500,000) was expended on such non-program-related items as a \$280,000 bonus to its Executive Director during fiscal year 1992, \$55,272 on luxury automobiles (e.g., a Porsche 944 Coupe) and \$3,247 on four season tickets to Boston Red Sox games. Because of the deficiencies we found relative to the contract negotiating and budgeting process used by state agencies, the Commonwealth cannot be assured that social service programs purchased by state agencies are being properly funded or administered or that the states funds are being used for their intended purpose.

3. **State Agencies Have Not Developed and Implemented Formal Processes for Determining Their Clients' Service Needs and in Some Instances Are Not Complying with State Laws and Regulations Relative to Involving Area Boards in Establishing These Service Needs. As a Result, the Commonwealth Cannot Be Assured That the Most Effective Types and Levels of Program Services Are Being Procured or Whether These Services Are Being Provided in an Equitable Manner:**

38

The Determination of Needs (DON) process is the first, and one of the most important, aspects of an agency's service delivery system. An effective DON process serves to ensure that agencies procure the type and amount of services that will best serve their target client population in the most effective and efficient manner and allocate their limited resources on a prioritized basis in concert with this determination. However, DPS regulations do not specifically require state agencies to develop and implement a formal DON process. As a result, at the five state agencies we found that the manner in which the DON process was utilized by these agencies varied significantly. Specifically, DMH was in the process of fully developing and implementing a formal DON process, while DSS had no formal DON process and was, in fact, in violation of some of its DON regulatory requirements. Finally, some state purchasing agencies are mandated by law to conduct annual needs assessments for the social services under their control as well as to establish area boards, which consist of representatives from the communities in each of their geographic service areas, to provide community input as to the types and levels of social services to be offered in their areas. However, based on our review, we determined that these state purchasing agencies were, in general, not conducting formal annual community area-based needs determinations and were not establishing area boards that functioned and operated in accordance with these regulations. Because some state agencies are not developing and implementing formal DON processes, the Commonwealth cannot be assured that the most effective types and levels of program services are being procured or whether program services are being provided in an equitable manner.

4. **State Agencies Are Not Maintaining Accurate Inventories of the Furnishings and Equipment Service Providers Are Purchasing with State Funds. As a Result, There Is No Assurance That the Millions of Dollars in State-Owned Property Provided to Service Providers Is Being Properly Safeguarded against Loss, Theft, or Misuse or Whether the Amount of Depreciation Being Claimed on Service Providers' Financial Statements Is Accurate:**
- State regulations require state agencies to maintain accurate inventories of their fixed assets (e.g., furnishings and equipment) that they use or provide to their contracted service providers to operate state-funded programs.

46

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

However, we found that five state agencies had not developed or implemented effective and efficient inventory systems relative to furnishings and equipment. Because these agencies did not have accurate records of the inventory of furnishings and equipment their contracted service providers purchased using state funds, the state cannot be assured that the millions of dollars in state-owned fixed assets at these service providers are being properly safeguarded against loss, theft, or misuse or that the state's inventory of fixed assets is being accurately reported on its financial statements.

Additionally, DPS's General Contract Conditions require service providers to maintain inventory systems that clearly identify which of their fixed assets were purchased with state funds as well as the source of these funds. In part, this requirement serves to ensure that service providers do not depreciate fixed asset items to which the state purchased and holds title. However, 14 of the 40 (28%) of the providers we audited were not maintaining inventories in accordance with the requirements of DPS's General Contract Conditions. These 14 providers had inventories valued in excess of \$4.1 million during the period of our review. Because these providers were not maintaining their inventories in accordance with DPS regulations, it could not be demonstrated how much of this \$4.1 million in furnishings and equipment was state-owned and, therefore, whether the depreciation that these providers were taking on these assets was appropriate.

REGULATORY DEFICIENCIES

51

1. **Inadequacies in DPS Regulations Relative to Related-Party Transactions Resulting in Millions of Dollars in Unallowable Expenses:** During our audit, we found at five (12.5%) of the 40 providers significant problems relative to related-party transactions, including some providers' failure to disclose their related-party relationships and their providing compensation to related parties for goods/services in excess of that allowed by state regulations. The total excessive compensation we found at these five providers exceeded \$2.3 million. We also found instances in which service providers were using state funds to secure loans for or provide loans to their related parties (e.g., family members) as well as other questionable related-party transactions. In some instances, these transactions could have adversely affected the financial stability of the providers, thereby jeopardizing the welfare of the clients whom these providers were serving. As a result of the number and significance of the problems we found relative to related-party transactions, DPS has taken measures to better ensure the proper disclosure of related-party transactions and to further limit payments that can be made to related parties. However, additional measures are needed to ensure that state funds are being properly safeguarded.

51

2. **DPS Has Not Established Effective Regulations or Guidelines Relative to Contracts Awarded by Service Providers. As a Result, Service Providers Are Expending Millions of Dollars on Questionable, Unallowable, and/or Unnecessary Contracted Goods and Services:** The Legislature and various governmental agencies have enacted laws and regulations, with which all state agencies must comply relative to the award and administration of contracts. In contrast, state laws or regulations do not require contracted social service providers doing business with the state to follow any contracting procedures or to

56

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

exercise sound business practices in procuring goods, services, or other items that are purchased with state funds. As a result of this lack of regulatory or other guidance, we found contract administration deficiencies at 12 (30%) of 40 social service providers. These deficiencies resulted in over \$2.5 million in questionable, unallowable, and/or unnecessary expenditures. Some of the serious problems we found included the noncompetitive awarding of hundreds of thousands of dollars in state funded contracts, in some cases to relatives or other related parties; not maintaining written contracts for the purchased goods or services; contract language being deficient; unreasonable and/or unnecessary consultant services being procured; full time staff of providers being hired by the providers as consultants; consultants being paid without submitting bills; and consultants being given loans and advances prior to their rendering any services. Because DPS has not promulgated regulations relative to the administration of contracts awarded by contracted service providers, the Commonwealth cannot be assured that the millions of dollars in contracts that service providers award each year using state funds are being properly safeguarded.

3. **DPS Should Establish Conflict-of-Interest and Antinepotism Requirements for Contracted Service Providers:** DPS should establish a minimum standard of conduct or code of conduct for the staff and board members of contracted service providers that expend public funds. This would help ensure that personal financial interests and relationships do not conflict with official responsibilities. Because there is no established standard code of conduct for service providers to follow, we found many instances that would be conflicts of interest under commonly accepted ethical standards if service providers were required to comply with standards such as, for example, MGL 268A. For example, we found a number of instances in which provider officials hired several immediate family members to work in management or other positions in their agencies and, in some instances were responsible for supervising and/or evaluating these family members. We also found many instances in which individuals became members of the Board of Directors of service providers and then directed business from this service provider to their places of business. 62

4. **Inadequacies in DPS Regulations Relative to Nonreimbursable Costs Resulted in Hundreds of Thousands of Dollars in State Funds Being Expended on Non-Program-Related and/or Other Nonreimbursable Items:** At 14 (35%) of 40 providers, we found significant problems relative to nonreimbursable/unallowable costs being charged by service providers against state contracts. For example, one service provider incurred \$93,245 in vehicle expenses during an approximately four-year period for luxury vehicles that were provided to administrative staff and not used for program purposes, while another service provider incurred \$96,260 in unnecessary and unallowable legal expenses during two fiscal years. These deficiencies were the result of inadequate monitoring by state agencies (see Systemic Problem No. 1) and the fact that during the period of our review, DPS regulations relative to nonreimbursable costs did not adequately ensure that state funds were being properly safeguarded, in that they were ambiguous and difficult to apply. Based on the results of our audits of service providers, DPS has taken measures to address some of our concerns relative to this matter. However, additional measures are necessary in order to ensure adequate controls over nonreimbursable/unallowable costs exist. 64

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

	Page
5. <u>DPS Should Develop Regulations or Guidelines Relative to the Composition and Activities of the Boards of Directors of Service Providers:</u> Section 6A of MGL Chapter 180 (commonly referred to as the Public Charities Law) empowers nonprofit organizations to make, amend, and repeal corporate bylaws. These bylaws can prescribe the number of board members an organization wants to have overseeing its operations as well as the manner in which these members will be elected to serve as board members; their terms of office; and their powers, duties, and responsibilities. The Board of Directors of a service provider is the primary organizational body that ensures that the agency meets its operational objectives in the most effective and efficient manner. Board members perform a variety of key functions, including overseeing the overall operations of the agency, setting policies and procedures to ensure agency objectives are met, and hiring the agency's top executive. Although a board of directors is a key component to the successful operation of an agency and its programs, the Commonwealth has not established any regulations or requirements relative to the general composition or conduct/activities of board members whose agencies do business with the state. As a result, we found a number of instances in which board members either engaged in questionable activities (see Regulatory Deficiencies No. 1 and No. 3) or did not adequately meet their oversight responsibilities for their respective agencies. We also found several instances in which the majority, if not all members, of an entity's Board of Directors were family members, employees, or consultants to the agency. The ability of such boards to independently and effectively govern the activities of the agency under such circumstances is questionable.	70
6. <u>DPS's Regulation Relative to the Amount and Use of Surplus Revenues by Service Providers Needs to Be Re-examined and Modified:</u> During the period of our review, DPS regulations relative to the amount of surplus state revenue contracted service providers could retain did not place sufficient restrictions on how these funds can be spent. Specifically, although these regulations specified that these surplus revenues should be used for charitable purposes, they do not state that these funds have to be spent in accordance with all applicable state laws and regulations. Consequently, we found many instances in which providers expended thousands of dollars that they generated from surplus state revenues on items such as parties and individual bonuses that would not be allowable under state regulations if these expenditures were charged directly to a state contract. Based on our audit work DPS amended its regulations effective July 1, 1994. These regulations now prohibit service providers from using any surplus state revenues for items that would be considered nonreimbursable under DPS regulations.	72
<p>Also, the 5% annual/20% cumulative surplus revenue retention allowance established by DPS may be excessive. This allowance was established primarily to allow service providers to adequately capitalize their operations. However, service providers are typically provided with capital budgets in addition to their regular program funding for this purpose. Also, service providers are allowed to capitalize and depreciate (recover the cost of) many of the furnishings, equipment, and other capital items they purchase that were not part of a capital budget provided by a state agency. Moreover, the formula DPS uses to calculate the amount of surplus revenue service providers can retain, limits the amount of state funded surplus revenue providers can retain to 5% annually and does not</p>	

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

	<u>Page</u>
take into consideration any surplus revenues the provider may have generated from other non-state sources. As such, the total amount of funds service providers are being allowed to retain may well exceed 5% and/or their reasonable capital needs. According to industry information that we examined, the median return on assets (a profitability or surplus revenue ratio) for all social service providers considered in this survey (both for-profit and not-for-profit), was only 3.7% during calendar years 1992 and 1993.	
7. <u>DPS Regulations Should Define Minimum Internal Control Standards and Require Service Providers to Document Their Internal Control Systems:</u>	76
According to standards published by the American Institute of Certified Public Accountants, it is the responsibility of management to establish and maintain an effective internal control structure. Good internal controls are essential in maintaining full accountability for resources and in achieving management objectives in the most effective and efficient manner. During fiscal year 1989, the state Legislature enacted Chapter 647 of the Acts of 1989. This statute defines the minimum level of quality acceptable for internal control systems to be established and utilized by state agencies and requires the internal control systems of an agency to be clearly documented and readily available for examination. Although this statute requires state agencies to develop, implement, and document adequate internal control systems over their operations, no such requirement exists for contracted service providers doing business with the state. As a result, at 33 (83%) of 40 service providers, we found problems with the system of internal control these providers had established over their operations. For example, for one provider these deficiencies resulted in \$37,592 in questionable payroll expenses and inadequate documentation to support \$99,352 in nonpayroll expenditures and \$435,438 in revenues.	
8. <u>DPS Should Clarify Its Regulations Relative to Lobbying Costs:</u>	80
DPS regulation 808 CMR 1.15 (18), effective August 2, 1991, prohibited service providers from using state funds to pay "any costs associated with lobbying activities." However, during fiscal year 1993, DPS amended this regulation, currently 808 CMR 1.15 (18), to prohibit state funds from being used to pay an individual for lobbying activities unless they are "incidental" to the individual's "regular and usual employment." The change in terminology in this section of DPS's regulations has made the prohibition on the use of state funds for lobbying activities more ambiguous. As a result, service providers could now use state funds to lobby members of the Legislature and/or executive branch and reasonably argue that their lobbying activities were "incidental" to their job function of providing social services to clients.	
<u>OTHER ISSUES:</u>	81
In addition to the systemic and regulatory problems we identified during our audit, we also found several technical/operational problems within the POS system, as detailed below.	

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

	Page
<p>1. <u>DPS and State Agencies Have Not Developed and Implemented Measures to Evaluate the Effectiveness of Component Pricing, and There Are Several Problems with DPS's Component Pricing Catalogue. As a Result, State Agencies That Choose to Utilize Component Pricing May Be Paying Millions More for the Same or Even Fewer Program Services without Any Improvement in the Quality of These Services:</u> For those state agencies that choose to utilize DPS's Component Pricing Methodology, program budgets are negotiated between state agencies and service providers using pre-established component costs contained in DPS's Component Price Catalogue (CPC). According to DPS, a component pricing methodology is supposed to provide a simpler and fairer pricing methodology for state agencies to use that would presumably improve the quality of program services by providing sufficient capital and equitable salaries to program staff.</p> <p>During fiscal year 1992, 11 state agencies and/or secretariats informed DPS that it would cost them at least an additional \$10 million during the next three fiscal years to utilize DPS's component pricing methodology when awarding some of their POS contracts. They also stated that in the absence of additional state funding, this would require them to eliminate or modify existing services, resulting in the displacement of clients or a reduction in the number of units they could provide.</p> <p>Although component pricing is going to cost the state substantially more to implement, neither DPS nor the state agencies currently utilizing component pricing have developed and implemented procedures to assess what effect, if any, component pricing has had on program services. As a result, the state may be paying millions more for the same or even fewer program services.</p> <p>We also found other significant problems with component pricing. For example, although the CPC establishes a range of salaries for each staff position, there are no policies and procedures in place to ensure that these negotiated salaries are ultimately paid to staff members. As a result, there is no assurance that component pricing is meeting one of its intended purposes of improving the quality of program services by providing equitable compensation to program staff. Also, the CPC may not be a feasible or equitable means of pricing contracts and does not establish reasonable controls, ranges, or limits for the amount of profits that a for-profit agency can make under state contracts.</p>	81
<p>2. <u>The Financial Information Being Collected by DPS through Its UFR Process Is Incomplete and Is Not Being Effectively Utilized:</u> DPS regulations, with exceptions, require service providers doing business with the state to file annually with DPS a standardized financial report called the Uniform Financial Statements and Independent Auditor's Report (UFR). This report discloses various financial information relative to service providers' operations. Our review disclosed several problems with the type of information being reported within UFRs, as well as with how this information is being utilized by state agencies and DPS, as follows:</p> <ul style="list-style-type: none"> o There is an inadequate audit trail between a provider's UFR, which details fiscal activities related to individual programs, and its actual state service 	87

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

contracts. Since UFR information is reported on a program basis (rather than on a contract basis), it is difficult for state purchasing and oversight agencies to monitor/analyze contract costs.

- o Not all operational deficiencies that could have an impact on program services may be identified and reported to DPS on UFRs.
- o Not all service providers who are awarded POS contracts are required to file a completed UFR with DPS. DPS' Audit and Preparation Manual under 808 CMR 1.00, identifies 14 exemptions to individuals or organizations in filing either a complete or partially completed UFR. As such, there is no consistent comprehensive POS data base that can be utilized as needed by state agencies to monitor/analyze program and contract costs.
- o DPS's review, input, analysis, and dissemination of UFR information is largely manual. This manual process is cumbersome and results in less timely and complete information being provided to state purchasing agencies.
- o The UFR information is being utilized by the state's principal purchasing agencies only to prequalify service providers and is not being used for other purposes, such as monitoring actual program costs or negotiating contract budgets.

Because of the problems we found with DPS's UFR process, the Commonwealth does not have a timely, comprehensive, and useful POS data base available to effectively monitor and evaluate POS-related activities.

3. **Inefficiencies in POS Contracting Process at Some State Agencies Resulted in Excessive and Unnecessary Costs:** Our audit revealed that the contracting practices utilized by some of the state's largest human service agencies are inefficient. For example, we found that one state agency, DMR, awarded 23 different contracts to the same provider for the same services in different geographic areas. By conducting these types of duplicative contracting activities, these state agencies are not utilizing their limited resources in the most efficient manner. 90
4. **Contrary to State Law, the Administration Has Not Appointed All the Members of the State's Social Service Policy Advisory Board:** According to St. 1992, c.133, s.113, the governor is mandated to establish a Social Service Policy Advisory Board to assist the assistant commissioner of DPS in policy decisions, including the promulgation of regulations relative to the POS system. However, we found that as of February 15, 1994, the governor had appointed only two of the 12 members whom he is required to appoint in accordance with the statute, and the Advisory Board consisted of only seven of the 18 members required by this statute. As a result, POS service users and contracted service providers cannot be assured that they have equitable input regarding the manner in which the POS system operates. 92

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

CONCLUSIONS AND RECOMMENDATIONS:

The relationship between state purchasing agencies and their contracted social service providers has evolved into one of mutual dependency. The five social service agencies we examined, which were among the state's largest, expended approximately 48% (weighted average) of their total fiscal year 1993 revenues on POS-related activities. Without contracted social service providers, these state agencies could not meet all of their mandated responsibilities of providing needed services to their clients. Similarly, the 40 service providers we examined received on average approximately 75% of their total revenues from state contracts. In essence, a significant number of these providers are able to survive only as a result of the state funding they receive. One problem inherent in the state's increasing dependency on purchased services is that the more the state becomes dependent on contracted social service providers to serve its clients, the more influential the service provider community will become in determining how the state's POS system operates and is funded. Consequently, the state must work at fostering and maintaining a highly competitive environment within the state's POS system. However, our review disclosed that currently not all state agencies procuring social services have taken measures to promote competition for their program services and that competition for these services is absent or inadequate. As a result, "market forces" cannot be relied upon to control those aspects of the system (e.g., program costs and quality) that could to some extent be controlled in a more competitive environment.

Given the dependent relationship between the state and its contracted social service providers, the POS system must operate to the benefit of all parties involved in the system to maintain equilibrium. To the extent possible, the system must be kept flexible enough to allow service providers to manage their own operations and deal with their own problems, (e.g., cash flow) without the state's attempting to micro-manage all aspects of their operations. Only by allowing providers to employ their entrepreneurial skills can the state hope to realize any cost savings and/or improvement in the quality of services that may be achieved by providing these services through a private versus a public entity. However, the state must take measures to preserve the integrity of the POS system.

Specifically, the administration, primarily through DPS, must establish an adequate system of internal controls over the POS system to ensure that state funds are being properly safeguarded and expended in compliance with all applicable laws, rules, and regulations and that services are being provided in accordance with the contractual terms and conditions of state contracts. Although adequate competition for POS-related services can, to some extent, serve the purposes of controlling costs and enhancing program services, comprehensive, timely, clear, and manageable regulations relative to POS are needed to ensure that the state meets the overall objectives of its social service delivery system. Such regulations, if properly developed and implemented, can be beneficial to the POS system in that they can be used to maintain the financial stability of service providers thereby fostering a more competitive environment. Such regulations would also serve to protect the interests of the taxpayer. Managers of private organizations doing business with the state should

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

be rewarded for effective management practices but should also be held accountable for meeting the public's interests and accomplishing the objectives of the programs they operate with public funds.

In order to effectively oversee and control or regulate the POS system, the state must keep in mind two basic facts. First, the vast majority of contracted social service providers doing business with the state are not-for-profit organizations established for the sole purpose of providing services to needy clients. Therefore, any measures the state takes to control, regulate, or modify the current POS system should ensure that state funds provided to service providers are used for their intended purposes and in concert with the stated missions of these organizations. No individual or organization should derive undue personal financial benefit or gain from the state's contractual relationship, nor should any funds be expended on any activities not related to the provision of the contracted social services. Second, the state has a fiduciary responsibility to the taxpayers of the Commonwealth to ensure that social services purchased by state agencies are procured and provided in the most economical and efficient manner and in accordance with all applicable laws, rules, and regulations. In effect, the Commonwealth must be a prudent buyer of POS-related services, taking measures to ensure that it only purchases services from well-managed, financially stable organizations that are capable of providing the necessary services.

Prior to the establishment of DPS, the Rate Setting Commission (RSC) established the rates of reimbursement for the majority of the state's contracted social service provider's, based on the providers historical costs with an allowance for inflation. This form of contract administration resulted in operational inefficiencies such as an undercapitalization of providers' activities and an incentive for providers to incur unnecessary costs simply to maintain their current levels of funding. This method of establishing program costs and rates of reimbursement changed with the establishment of DPS. Currently, most of the contracts awarded by state agencies establish rates of reimbursement through a negotiation process between the state purchasing agency and the provider, using a cost guide developed by DPS called a Component Price Catalogue (CPC). In theory, component pricing, although more costly, is supposed to provide state agencies with an easier and fairer (market-based) method of pricing POS contracts. In addition, this pricing methodology is meant to enhance the quality of services being provided to clients in state-funded programs by providing service providers with more resources to operate their programs. This type of contracting process is not without flaws. For example, contract maximum obligations may be more reflective of the effectiveness of the negotiators than the actual needs of the program. Also, the additional flexibility in pricing contracts and managing program services afforded to providers under this new POS system necessitates greater oversight activities and more effective internal controls by state purchasing and other oversight agencies. However, in practice, we found that the state agencies are not effectively monitoring and evaluating program services or service providers and that DPS and these state agencies had not developed or implemented policies or procedures to determine what effect, if any, component pricing has had on program services. Rather, we found that state agencies were establishing dysfunctional and unrealistic program

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

budgets and were using the concept of component pricing to rationalize their not effectively monitoring program costs. This practice has in fact eroded the integrity of the POS system in that the Commonwealth cannot be assured that program services are being adequately funded or that the objectives of the programs are being achieved.

The current ideology within the state's POS system is to advocate the use of component pricing and to be primarily concerned with outcome measures (e.g., performance-based contracts) as the means of assessing program services and quality. State agencies are primarily concerned with obtaining specified results in terms of service units (e.g., a specified number of days and services for a client in a community residence) and are not as concerned with inputs, monitoring the reasonableness of these inputs, and, in some cases, the processes that are employed in obtaining these results. While desired outcomes are and should be the primary goals of POS contracts, state agencies must strive to make use of intelligent inputs and processes by developing and implementing effective standardized pricing strategies and program evaluation measures. Moreover, state agencies must establish processes and procedures that correlate program inputs to process quality and program outcomes in order to adequately assess the effectiveness and efficiency of the program services that are being delivered. However, our review disclosed that the program budgeting/pricing and monitoring procedures being utilized by state agencies relative to POS services does not ensure that program services are fairly priced. This has resulted in some providers' realizing excessive revenues from POS contracts while, on average, service providers within the POS system are experiencing financial deterioration due to inadequate state funding and inefficient management practices.

DPS has been given an immense responsibility and has taken measures to improve the efficiency of the POS system (e.g., through standardization of various forms and reports). DPS has also attempted, through its regulations, policies, and procedures, to inject some flexibility into the system, which should enhance the state's ability to realize some of the potential benefits of free-market conditions to the extent that they exist. However, DPS has not been given adequate resources to effectively meet its management and oversight responsibilities. As a result, the current POS system is antiquated and not being adequately monitored. The vast majority of the information that relates to state agency and service provider activities within the POS system is manually recorded and/or reported. Consequently, much of information being generated within the POS system is untimely and/or not being effectively utilized. Therefore, the administration must make every effort to develop a POS management information system from a common data base of information. This system will reduce the logistical and operational efficiencies and inconsistencies (e.g., monitoring and budgeting) that currently exist and that transcend all aspects of the POS system.

During our review we found a number of systemic, regulatory, and other operational deficiencies within the state's POS system. As pointed out in our report, DPS has been very responsive to our concerns and has taken prompt and decisive measures to address some of the deficiencies we found within the system. In fact, it should be noted that, based on the results of our audit work, in April 1994 DPS proposed amendments to 808 CMR 1.00 and took regulatory and other measures during our review to address concerns raised in our

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

audits. However, in order to effect better control over the state's POS system, further measures should be taken. Our general and specific recommendations to help improve the POS system, which appear in their entirety in the text of this report, are summarized below:

GENERAL RECOMMENDATIONS:

1. DPS regulations should be made more stringent by containing penalties for noncompliance. Also, DPS regulations should include a provision that all records be made available to audit/oversight agencies in a timely manner. Failure to do so should result in a penalty or the suspension of contractual payments.
2. As detailed in the Audit Scope, Objectives, and Methodology section of this report, our special-scope audit focused on an examination of the adequacy and effectiveness of the administrative and accounting internal controls established by DPS over certain aspects of the POS system. In order to make the system as effective and efficient as possible, additional reviews should be conducted to fully analyze all aspects of the POS system. Such reviews should be directed towards, but not limited to, reducing POS-related administrative costs; eliminating duplicative activities, paperwork, and staffing; and more efficiently sharing POS information between state agencies (e.g., automating the collection and distribution of POS information). The Secretary of EOHHS, in conjunction with DPS, the Executive Office for Administration and Finance (EOAF), and other state agencies, should establish a task force to determine the technical and operational aspects of these reviews, how each review will be staffed, and how the results of each review will be utilized.

SPECIFIC RECOMMENDATIONS:

Our report makes a number of recommendations as to how the POS system can be improved. These recommendations, which follow each audit result detailed in this report, are as follows:

1. **Monitoring:** In order to ensure more effective, efficient, and consistent monitoring over POS-related activities:
 - a. DPS should amend its current regulations to contain specific minimum standards for monitoring and evaluation that state agencies need to perform. These activities should address all areas of program monitoring/evaluation, including data collection, analysis and synthesization; communication of the results; and corrective action measures. For example, in regard to program evaluation, these regulations should prescribe the frequency (e.g., annually) of these evaluations, be based on pre-established performance indicators, as defined in the contracts, that can be measured and that relate to the stated goals and objectives of the program and to specified program outcomes. Each state purchasing agency should be required to submit an annual program evaluation plan to DPS subject to DPS's approval. Each program evaluation plan should become an integral part of the state purchasing agency's contract procurement/renewal process. State agencies should ensure that monitoring forms are developed and the monitoring/evaluation teams collectively possess the necessary skills to accomplish the goals and objectives of the agency's monitoring activities.

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

- b. DPS should require state agencies to transmit the results of their monitoring activities for the purposes of establishing a POS data base. This data base could be used to develop a POS-related information infrastructure that could be used by all state agencies in the contracting process.
- c. DPS should continue to provide training to state agencies in effective monitoring and evaluation activities.
- d. DPS should require state agencies to formally appoint and identify contract performance managers for each state contract. State agencies should also be required to identify specific duties and responsibilities to be performed by such individuals.

In addition to the operational/procedural changes recommended above, state agencies need the resources to effectively implement efficient and effective monitoring and evaluation systems. The state Legislature should consider taking the following measures:

- e. Designate a certain portion of each state agency's annual appropriation to be used for program-related monitoring and evaluation activities.
- f. Provide sufficient funding to DPS so that DPS can (1) implement an effective UFR review process; (2) develop, implement, and oversee/coordinate a statewide POS-related program monitoring system and data base; and (3) increase training on efficient and effective monitoring and evaluation activities. (Some of the funds needed to perform these tasks may become available through the cost-saving measures detailed in Other Issues No. 3.)

2. **Budgeting:** In order to ensure that POS contracts are being adequately funded, we recommend that DPS take the following measures relative to contract budgeting and negotiations:

- a. Based on the information it obtains through its UFRs, DPS should develop a POS data base and corresponding management information system that collects and analyzes service providers' costs, as detailed by service type and geographic location, and that produces statistical summaries of this information for each fiscal year. DPS should also use this information to conduct regular financial analyses of this information to ascertain the financial condition of service providers and the POS system as a whole and take the measures it deems necessary to address any problems noted.
- b. DPS should amend its current regulations to include formal budgeting/budget monitoring procedures that state agencies should follow. DPS should also require state agencies to annually review actual to budgeted program costs prior to renewing these contracts and obtain explanations from providers for any significant variances that may occur between these two costs.
- c. DPS should continue to develop training programs relative to contract negotiations and contract renewals that would address information, regulations, industry guides, and other reports that should be reviewed by the purchasing state agency prior to the negotiation process.

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

- d. The administration should determine the resources necessary to implement the recommendations identified above and ensure that state agencies have sufficient resources available to implement these or other changes that DPS decides to make relative to the budgeting and budget-monitoring process.
3. **Determination of Service Needs:** Since many of the social services procured by state agencies are unique, it would not be practical for DPS as the oversight agency to develop a single DON process to be utilized by all state purchasing agencies. However, DPS should require state agencies to develop, implement, and document a formal DON process. This formalized process, at a minimum, should be in writing, reviewed and/or approved annually by the head of each agency, and modified as necessary to meet the changing demographics and specific service needs of each agency's client population. Any process developed by state agencies should ensure that input is received from those communities in which the services are being delivered and that program services are delivered on a fair and equitable basis and in the most efficient and effective manner. The data generated through an annual needs assessment must be part of the budget debate and serve as the basis for allocating state-appropriated funds. Further, all state purchasing agencies must comply with their statutory mandates relative to the make-up and role of area boards.
 4. **Inventory:** In order to effect better control over the furnishings and equipment that contracted service providers purchase with state funds, we recommend the following measures:
 - a. Where applicable, state agencies should take the measures necessary to fully comply with the requirements of 802 CMR 6.00 and implement effective asset-management systems. In addition to those state-owned assets in the possession of the state agency, these systems should include the proper accounting for those assets purchased by service providers with state funds.
 - b. In order to ensure the accuracy of the information within their asset management systems, state agencies should detail how assets, particularly multiple purchases of the same items, should be valued by the purchasing entities (i.e., regional and/or area offices). Also, state agencies should require their contracted service providers to conduct annual inventories of their state-owned items and submit a complete listing of those items to their principal state purchasing agency. These listings should indicate a description of the item, its location, historical cost (including shipping and installation), date of requisition, the amount of state-agency funds used to purchase the asset, and where applicable, the date of disposition and the reason for disposition (e.g., obsolescence, theft). Principal state purchasing agencies should disseminate this information to DPS and the applicable state contracting agencies.
 - b. DPS should establish and require service providers to follow standard inventory procedures. In addition to what is already required by DPS regulations and general contract condition, those policies and procedures, at a minimum, should address how service providers should account for and report inventory acquisition.

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page**RECOMMENDATIONS RELATED TO DPS REGULATIONS:**

- A. **Related-Party Transactions:** In order to effect better control over related-party transactions, we recommend that DPS take the following additional measures:
- o Specifically prohibit certain related-party activities (e.g., providing loans to or collateralizing loans for related parties) that could have an adverse financial impact on the operations of the contracted service provider. Providers should be required to demonstrate that all related-party transactions are at the lower of actual or fair market cost in order to be allowable.
 - o Continue to provide and require training on the proper identification and disclosure of related-party transactions to service providers, private auditing firms, and other interested parties.
- B. **Contract Administration:** We urge the passage of legislation that would require contracted service providers to utilize a competitive bidding process when awarding contracts for supplies or services that are being paid for with state funds, given the significance and pervasiveness of the problems we found with the contract administration activities of service providers. However, pending a statutory requirement, we recommend that DPS promulgate regulations that would establish specific contracting and administration activities that contracted service providers would be required to follow as a condition of doing business with the state. DPS should also take the measures it deems necessary to ensure that any state-funded contract awarded by a service provider contains fundamental elements that would ensure that purchased goods or services were necessary and appropriate and that contracted services were delivered.
- C. **Conflict-of-Interest and Antinepotism:** Comprehensive measures are needed to ensure the integrity of service provider activities as they relate to potential conflict-of-interest situations. We therefore recommend that DPS develop a comprehensive code of conduct and ethical standards with which all contracted service providers doing business with the Commonwealth must comply. This code of conduct should apply to all provider staff as well as to members of their Board of Directors. Any provider found to be in violation of this code should be subject to debarment from state contracts, in accordance with Chapter 550 of the Acts and Resolves of 1991.
- D. **Nonreimbursable/Unallowable Contract Costs:** In addition to the measures already taken by DPS, we recommend the following:
1. DPS should amend 808 CMR 1.15(22) to be applicable to all state-funded programs and not just those that receive federal financial assistance.
 2. DPS should amend 808 CMR 1.15(5) to require that, in order for a particular consultant service to be reimbursable under a state

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

contract, the provider at a minimum, must be able to demonstrate the following to its PPA and DPS:

- o There was a definite, measurable need for the service, which could not be provided by the provider's existing staff.
 - o The rate of compensation is at fair market value.
 - o There is a contract for these services that delineates all the terms and conditions of the agreement, including measurable deliverables.
 - o The consultant is qualified to provide these services.
3. DPS should amend 808 CMR 1.15(12) to be more specific (e.g., by making nonreimbursable any expense that the provider cannot demonstrate directly benefitted a state-funded program and was not directly related to the social service program purposes of the provider's state contracts).
 4. DPS should continue to provide and require training to providers, private auditing firms, and other parties involved in the state's POS system regarding what costs are allowable and unallowable under state contracts.
 5. DPS should also consider strengthening certain aspects of its regulations. For example, federal Acquisition Regulations 31, 201-3(A) puts the burden of proof as to the reasonableness of an expense on the contractor (i.e., service provider) by stating:

If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.

DPS should consider clearly establishing reasonableness criteria in its regulations and requiring that the burden of proof as to the reasonableness of an expenditure is on the service provider.

- E. **Composition and Activities of Board of Directors:** DPS should develop and implement regulations or guidelines relative to the activities of a provider's Board of Directors.
- F. **Surplus Revenues:** In order to ensure that state funds are properly safeguarded, DPS should take the following measures relative to its Not-for-Profit Provider Surplus Revenue Retention Policy:
 - I. DPS should re-examine the 5%/20% revenue retention allowance for reasonableness, as compared to not-for-profit industry standards, and adjust these percentages, as necessary. Also, DPS should require that all unrestricted sources of revenues that providers generate be included in their revenue retention allowance.

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

- II. DPS should consider requiring service providers to account in a separate fund for the source and use of surplus revenues they receive from their state contracts and prepare an annual statement of changes in fund balance that specifically identifies the sources and uses of funds from this account. Service providers should be required to submit this audited financial statement to DPS along with its UFR.
- G. **Internal Control Standards:** DPS should develop an internal control guide for service providers similar to the one issued by the Office of the State Comptroller and provide this to all providers. DPS should amend its current regulations and, based on this guide, require service providers to develop and implement an adequate internal control structure and submit a standard form with their UFR each year documenting this structure.
- H. **Lobbying Expenses:** In some instances it may be beneficial for the state to allow contracted service providers to pay for lobbying activities. For example, federal cost principles for nonprofit organizations, as contained in OMB Circular A-122, allow contracted service providers to incur lobbying expenses relative to influencing state legislation to avoid material impairment of their authority to perform their grant, contract, or other agreement with the federal government. We therefore recommend that DPS amend 808 CMR 1.15 (18) and make this regulation clearer by stating specifically under what circumstances lobbying costs will be allowed.

RECOMMENDATIONS TO OTHER OPERATIONAL AND TECHNICAL PROBLEMS RELATIVE TO THE POS SYSTEM NOTED IN OUR REPORT:

- 1. **Component Pricing:** Since component pricing has not been demonstrated as a less costly and viable contract pricing option, DPS should conduct a current cost-benefit analysis of the component pricing initiative. DPS should not fully implement component pricing until such a study has been conducted. In order to do this, DPS, in conjunction with other state agencies, should identify the aspects of program quality that should be measured. Aspects should be identified for individual programs as well as the entire service delivery system. DPS, in conjunction with the appropriate state agencies, should then develop and implement either agency-specific or systemic policies and procedures for collecting and analyzing these qualitative measures. DPS should focus on correlating program inputs to the different processes or program types used to provide services to program outcomes.

If, based on this review, DPS determines that component pricing is a cost-effective method of pricing state contracts, it should take the following measures:

- a. In order for DPS to ensure that this type of contract pricing can be effectively administered, it should require that this method be implemented systemwide. Once every state agency is using the same contract pricing methodology, DPS can justify allocating some of its limited resources to develop and implement systemwide controls over the process.

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

- b. DPS should further refine the information in its CPC, as follows:
 - o Make the information more program-specific by establishing salary ranges by service/program type (e.g., day care, educational/vocational, and health care services).
 - o Establish within its CPC a salary floor for service providers' program staff. DPS should require the private auditing firms to conduct audit tests to ensure that providers do not pay agency staff salaries below this amount. This will allow providers to continue to benefit from efficient management practices and at the same time maintain and potentially improve the quality of program services by reducing staff turnover and improving employee morale.
- c. DPS should establish a POS database showing program component costs by industry and by geographic location. DPS should not only use this information in developing/updating its CPC each fiscal year, but should also make this information available to each state purchasing agency. This information, in addition to the historical cost information detailed in each service provider UFR, could be used by state agencies in their contract negotiation processes.

If, based on its analysis, DPS determines that component pricing is not a viable, cost-effective option, it should develop a more efficient and effective approach to contract pricing.

2. **UFR Information:** The following measures should be taken to ensure the effective and efficient oversight of all social service providers doing business with the state.
 - a. UFR reporting should be mandated for all social service providers that receive state funding in excess of a minimum amount in POS contracts established by DPS.
 - b. DPS should establish an automated UFR database and reporting system. Such a system should require service providers to electronically file UFR information to DPS. In establishing this system, DPS should ensure that the system has an appropriate system of data checks for reasonableness and accuracy of the data transmission. Programs to routinely analyze UFR data should be made part of the system, and the system should be set up as a network so that all POS agencies and the RSC can access, but not manipulate, this data.
 - c. DPS should develop and implement a more formal method on the UFR of being able to correlate crosswalk program costs to contract costs. Upon request, DPS should make this information available to state purchasing agencies and other interested parties. Also, based on our audit, many state officials as well as officials of contracted service providers with whom we spoke were dissatisfied with both the UFR and/or the UFR process. In view of this, DPS may want to periodically solicit information from state

TABLE OF CONTENTS/EXECUTIVE SUMMARY (Continued)

Page

agencies, service providers, and private auditing firms providing services within the POS system as to any problems, concerns, or criticisms they may have relative to the UFR or the UFR process and make the appropriate changes to this process and documents based on such information.

- d. DPS should develop specific guidelines as to how state purchasing agencies should use UFR information provided to them by DPS, and DPS should conduct training sessions on this subject with state purchasing agency officials.
 - e. DPS should continue to provide and require training to private auditing firms relative to the conduct of generally accepted government auditing standards (GAGAS) audits of human service providers.
3. **Inefficiencies in the POS System:** DMH, DMR, and DSS should reexamine their procurement activities relative to POS contracts and take the measures necessary to ensure that these services are procured in the most efficient manner. Given the logistics involved in the POS system (i.e., the number and types of contracted services being procured, the number of clients being served, and the amount of dollars being expended) the state should examine the feasibility of automating the procurement process within the POS system. For example, the March 1993 edition of Governing Magazine noted that the State of Oregon had recently made a conceptual leap by stating "that the State should not be paying the vendors to do business with us." In other words, the state should not be incurring unnecessary costs just to solicit and procure business from contracted service providers. As a result, this article states that the State of Oregon automated its RFP process which resulted a significant reduction in costs associated with that state's RFP process, increased the number of proposals per contract Oregon received, and reduced program costs because bidders would examine all the information relative to the winning bids, which caused them to lower their bids during the next bid cycle to be more competitive.
 4. **Social Service Policy Advisory Board:** The administration should comply with the requirements of St. 1992, c.133, s.113 and appoint all the members of the state's Social Service Policy Advisory Board. If, however, the administration believes that this advisory board would not be an essential part of the state's POS system, then it should take measures to repeal the legislation that established this advisory board.

SUPPLEMENTARY INFORMATION

94

APPENDIXES

A. Audit Sites Visited	95
B. State Agencies That Purchase Social Services	99
C. Description of Audited State Agencies	101
D. Description of the Expenditures and Object Codes in the "MM" Subsidiary Account That Were Subject to Our Review	109
E. EOHHS Purchase of Service Task Force Draft Report Recommendations	110
F. Bibliography of Referenced Publications	113

INTRODUCTION

During fiscal year 1992, the Office of the State Auditor (OSA) began a comprehensive statewide review of the state's purchase-of-service (POS) system relative to social services. This review was initiated as a result of growing concern by members of the state Legislature, state purchasing agencies, the general public, and the business community over what the state was receiving in return for the more than \$1.6 billion that it was spending annually (fiscal year 1993) for social service programs and services as well as from our survey reviews and preliminary audits of certain providers.

Since the state's POS system is immense and complex, the OSA's approach to reviewing and evaluating this system was to systematically analyze its different components. This report, our first analysis of the state's POS system, details the results of our review of the administrative and accounting controls (e.g., POS policies, procedures, contracting conditions, required financial reports, and reporting requirements) established and implemented by the state's Division of Purchased Services (DPS), the agency responsible for administering and overseeing the state's POS system. Our report assesses the adequacy and effectiveness of these controls and the extent to which both state agencies and contracted service providers are complying with the statutory and/or administrative requirements that govern the operation of the POS system. In addition, our report makes recommendations as to how the administrative and accounting controls established and implemented by DPS can be improved to better ensure that state funds are being properly safeguarded and expended in an economical and efficient manner for their intended purposes, and in compliance with all applicable state laws, rules, and regulations.

A separate review of the POS system, which involved a special-scope review of the reasonableness, allocability, and allowability of indirect costs being charged to the state by contracted service providers is detailed in Audit Report No. 94-4029-3.

Background

During the early 1960s, social service¹ providers were predominantly long-established philanthropic organizations providing specialized services to target groups of individuals. At that time, Massachusetts, as well as most other states, directly provided state-funded social services. However, in the mid 1960s, in recognition of government's failure to make significant progress in solving various social problems (e.g., how to effectively treat mentally ill or handicapped individuals) Congress and various state governments began to take action to shift the responsibility for providing social services from government agencies to private, not-for-profit organizations.

At the federal level, these actions included: (1) passage of the Community Mental Health Center Act of 1963, which authorized construction of clinical facilities to provide a full

¹ For the purposes of this report, the term "social services" refers to all the health, educational, social, rehabilitative, and other services purchased by state agencies through the state subsidiary and object codes, as described in Appendix D of this report.

range of inpatient and outpatient services for the mentally retarded; (2) the 1967 amendments to the Social Security Act, authorizing federal reimbursement for up to 75% of state expenditures on services purchased from for-profit and not-for-profit providers; (3) the 1969 amendments to the Social Security Act, allowing privately donated funds to be substituted for state funds in matching federal social service grants; and (4) the 1974 amendments to the Social Security Act (Title XX), which made contracts between the state's social service agencies and private providers an eligibility requirement for federal reimbursement.

Within Massachusetts, the increase in state expenditures for purchased social services has been attributed by various sources (see Appendix F) to several significant factors, including a philosophical change in how mentally ill, mentally retarded, and juvenile offenders should be treated; the deinstitutionalization of clients residing in state mental health facilities brought about by consent decrees issued in the early 1970s;² and more recently, the desire of the current administration to reduce the size of state government by purchasing, rather than directly providing, these services. Also, according to one report issued in 1981 by a Blue Ribbon Commission of the Department of Mental Health, it was essential for government to fund certain social service programs because, by its nature, the private sector would service only those clients that could most readily pay for social services, thereby making these services unavailable to the majority of the state's clients.

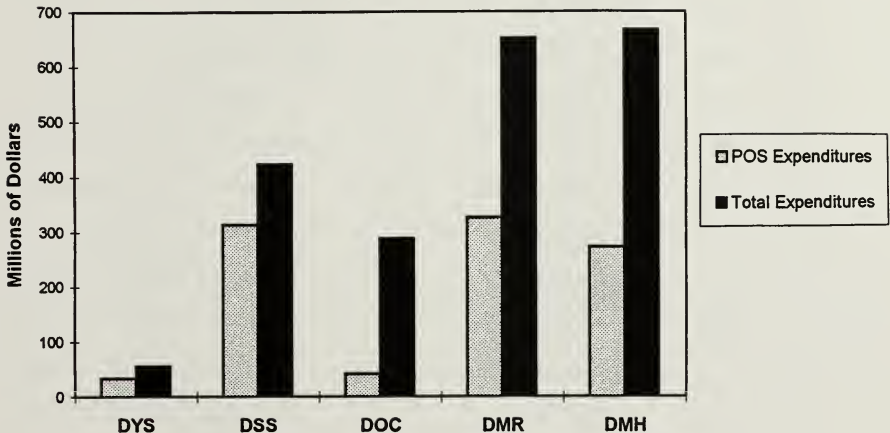
As a result of the conditions noted above, state expenditures for purchased social services have increased dramatically over the past two decades. In 1971 the Commonwealth expended approximately \$25 million for these services. However, during fiscal year 1993, the Commonwealth purchased in excess of \$1.6 billion and awarded contracts to over 1,980 social service agencies/providers to provide these services.

As state expenditures for POS-related activities have grown, so has the state's dependency on social service providers to provide community-based services for state agencies. As can be seen from the Table B on page 4, as of the end of fiscal year 1993, the Executive Office of Health and Human Services (EOHHS) agencies purchased 74% of all POS services, and, as indicated in Table A on page 3, the five state agencies we audited expended approximately 48% (weighted average) of their total revenues on POS-related services. Consequently, any collapse in the provider service network in the state would have a devastating effect on certain state agencies and on the clients these agencies serve.

² Beginning in 1972 a series of class action suits were filed on behalf of the clients residing in the Belchertown, Monson, Walter E. Fernald, Wrentham, and Paul A. Dever State Schools alleging that these facilities were overcrowded, understaffed, unsanitary, and unnecessarily restrictive for clients. As a result of these suits, the Commonwealth, through consent decrees, agreed to provide appropriate treatment to the clients in these facilities in the least restrictive environment compatible with that treatment.

TABLE A

**POS Expenditures Compared to
Total Agencies Expenditures
FY 1993**



Although the state's dependency on social service providers has increased, not all state agencies have taken measures to promote effective and efficient competition among their contracted service providers to ensure that quality program services are purchased at the lowest possible cost. In November 1993, the state's Executive Office for Administration and Finance (EOAF) issued a report entitled "Privatization in Massachusetts: Getting Results." In this report, the administration contends that there is adequate competition (an average of four bids and as many as 54 bids per contract) for state contracts from private companies for such services as skating rink operations, dietary and/or housekeeping services, highway maintenance, and social services by stating, in part:

Many opponents of privatization are simply misleading the public. For example, some leading opponents often cite that contracts receive on average only 1.7 responses, thereby mitigating the supposed benefits of competition. This figure is drawn from a study of Department of Mental Health (DMH) contracts only published seven years ago. During the Weld Administration, agencies received on average 4 bids per contract. In some instances as many as 54 bids were received when the privatization initiative was broken up into its component parts. . . during the Weld administration, DMH received on average more than 7 bids per contract.

TABLE B

Total POS Expenditures (MM Subsidiary)-Fiscal Year 1993**

<u>EOHHS Agencies</u>	<u>POS Expenditures</u>	<u>Percent of Total POS Expenditures</u>
Disabled Persons Protections Comm.	\$ 67,745	-
*Department of Mental Health	271,964,070	17%
*Department of Mental Retardation	325,413,965	20%
Department of Public Health	142,940,748	9%
*Department of Social Services	313,797,561	19%
*Department of Youth Services	34,702,879	2%
Mass. Commission for the Blind	5,537,068	-
Mass. Commission for the Deaf	1,585,150	-
Mass. Rehabilitation Commission	30,970,119	2%
Office for Children	1,532,179	-
Office of Refugee Information	3,644,971	-
Office of Veterans Services	2,703,011	-
Department of Public Welfare	74,540,419	5%
Chelsea Soldiers Home	381,971	-
Holyoke Soldiers Home	<u>142,803</u>	<u>-</u>
Total EOHHS Agencies	<u>\$1,209,924,659</u>	<u>74%</u>
*Department of Correction	42,651,333	3%
Executive Office of Communities & Development	65,505,963	4%
Executive Office of Elder Affairs	144,794,179	9%
All Other Agencies	<u>166,482,164</u>	<u>10%</u>
Total POS Expenses	<u>\$ 1,629,358,298</u>	<u>100%</u>

* Agencies subject to our review.

** This data was extracted from reports generated by the Office of the State Comptroller.

However, at the state agencies we audited, we found inadequate competition among contracted service providers. For example, during fiscal year 1993, the Department of Youth Services (DYS) issued 12 Requests for Proposals (RFPs) and ultimately awarded 11 contracts for program services. In response to these RFPs, DYS received only 15 proposals (1.25 per contract). For nine of these 11 contracts (82%), only one proposal was submitted, and this was by the service provider who already had the contract for these program services. Similarly during fiscal year 1993 the Department of Mental Retardation (DMR) issued 298 RFPs for program services. As a result of this RFP process, DMR awarded 261 (88%) of these contracts to the service provider who was currently providing the program services and received only one proposal for 210 (71%) of the RFPs it issued for program services during fiscal year 1993. Finally, we found that, contrary to what EOAF states in its report, DMH received an average of only 1.73 proposals for the 145 contracts, totaling approximately \$34 million, that it awarded for program services during fiscal year 1993.

Prior to EOAF's report, the state's POS system has been evaluated by a number of public and private organizations. For example, in 1980 the Massachusetts Taxpayers Foundation Inc., (MTF) issued a report entitled "Purchase of Service: Can State Government Gain Control?" This report which criticized state agencies for not having developed adequate program or fiscal controls, stated, in part: "what has developed is a provider-dominated purchase system which contributes to the state's lack of effective fiscal and program control." This report recommended that the state:

1. Improve its ability to provide services directly instead of contracting for them;
2. Develop a system that encourages genuine competition among providers for state dollars and programs; and
3. Regulate providers in a manner similar to the way it regulates public utilities, recognizing that providers are now a significant and essential part of the social services system.

In April 1986, the Senate Committee on Ways and Means issued its report of the state's "07"³ purchase of service system entitled "Purchase of Service: Protecting the Promise of Community Based Care." This report states that one of the major problems with the POS system is that the state's decentralized administrative structure is not compatible with the effective delivery of community-based "07" services: "Central oversight of social and rehabilitative service contracting has therefore developed, like the community-based system itself, in a piecemeal and generally uncoordinated fashion. The result is a system which gives a number of independent and

³ The legislative Joint Committee on Ways and Means established the "07" subsidiary account, from which all individuals/firms providing social, rehabilitative, health, or special education services were paid until June 30, 1991. Subsequent to this date, a new subsidiary account, MM has been used to fund the majority of purchased program/client services, see Appendix D for a complete description of the expenditures and object codes within this subsidiary account that were subject to our review.

organizationally diverse state agencies oversight of a \$614 million [in 1986] system." Based on the results of their review, the committee made a number of recommendations, including creating a new Office of Purchased Services within EOAF to conduct long-range planning, set standards, and coordinate the activities of both contracting and oversight agencies.

In response to the Senate Ways and Means report, in May 1987, Chapter 206 of the Acts of 1986 established within EOAF the Office of Purchased Services (OPS). Additionally, EOAF hired an Assistant Secretary for EOAF to oversee this office and develop and implement a consistent, efficient, and accountable system for agencies of the Commonwealth that contract for social and rehabilitative services. On January 31, 1990, OPS was closed and the Assistant Secretary issued a final report on POS entitled "Purchase of Service System Reform."

This report defined the two principles that governed OPS's review of the POS system: (1) the client comes first; and (2) the provider and the state are partners and must realize that the provider must survive as a business in order to perform its mission. This report contained an agenda for reform of the current system, including a proposal for the creation of one department that would be responsible for the administration of purchased services for all state agencies. According to this report, this department would need systemwide responsibility for pricing, auditing, and managing all POS activities and would be located within EOAF or the Office of the State Comptroller. This report indicates that resources could be made available to staff such a department, by eliminating existing offices and functions from the Office of Audit Accounts (OAA) within the Executive Office of Human Services and also positions from the Rate Setting Commission's Bureau of Educational, Social, and Mental Health Services (BESMHS).

During fiscal year 1991, the state Legislature enacted Chapter 138 of the Acts of 1991 (the state's fiscal year 1992 budget), which established the aforementioned department.⁴ Specifically, Section 99 of this legislation establishes DPS within the state's Department of Procurement and General Services (DPGS), but not subject to its control. DPS was given the responsibility of implementing and coordinating an efficient and accountable system of procurement, selection, pricing, contract administration, program monitoring and evaluation, contract compliance, and postaudit for any department, agency, board, or commission of the Commonwealth that procures or pays for social service programs from providers. Currently, DPS is organized into four bureaus,⁵ as follows:

The Pricing Bureau is responsible for establishing standards for pricing purchased programs. This may occur by means of the publication by DPS of pricing standards for use in the negotiation by state agencies of provider contracts. In the case of special education services, and in certain other cases, DPS sets the actual rates directly.

4 This legislation was superseded by St. 1992, c. 133, s. 113.

5 The description of DPS's bureaus was primarily extracted from its Purchase-of-Service System User Handbook, issued in October 1992.

The Bureau of Technical Support is responsible for providing ongoing support and assistance to purchasing agencies and providers regarding the technical aspects of contracting with the Commonwealth. This may include assistance in developing contract forms and POS-related guidance materials, in explaining how to utilize the Commonwealth's automated accounting system to facilitate contract approval and reimbursement, and in implementing data systems that will allow all interested parties access to important information about the nature and functioning of the POS system.

The Bureau of Program Development attempts to serve the needs of purchasing agencies and providers by understanding the programmatic goals and objectives of those agencies and working with all parties to determine the purchasing mechanism best suited to those goals and objectives. This bureau also works with purchasers and providers to address a variety of ongoing programmatic issues arising in the context of the Commonwealth's contracting system and to assist purchasing agencies in developing and implementing more effective monitoring, evaluation, and quality assessment functions.

The Bureau of Audit is responsible for establishing and implementing audit standards for independent financial and performance audits of providers of social and human service programs as well as for governmental entities. These audits are to be conducted in a manner consistent with generally accepted government auditing standards (GAGAS). This bureau also works to ensure the quality of POS audit activity through the use of routine review and resolution practices. DPS, through its Bureau of Audit, has also established an Audit Resolution Policy (Document No. DPS-A025) to address the findings and recommendations contained in audits of publicly funded social service programs that have been conducted by the OSA, federal agencies, and independent auditors who performed their audits in accordance with GAGAS. DPS, through its Bureau of Audit, also annually issues an Auditor's Compliance Procedures Supplement (Publication No. 16, 900-91-2800-7-91-C.R) to be used as a guide by auditors of entities conducting audits doing business with the Commonwealth.

With the establishment of DPS, the operation of the Commonwealth's POS system substantially changed. For example in terms of Pricing Program Services, the state's Rate Setting Commission (RSC) was responsible for establishing the unit rates of payment for contracted social services. These unit rates were primarily based on RSC's audit of annual forms/cost reports (typically, RSC 1100 forms) submitted by service providers that indicated the provider's historical program costs. Currently, DPS has assumed the responsibility for pricing certain social service contracts from RSC. DPS directly establishes reimbursement rates for certain services (e.g. special education) and has developed and administers standards for pricing purchased programs by other state agencies (excluding any program or service that is reimbursable under Title XIX of the Social Security Act, commonly known as Medicaid). However, rather than basing contract budgets on historical costs plus an inflation factor, as was typically done by RSC, DPS has developed what it calls a Component Price Catalogue (CPC). According to DPS officials, the CPC contains standard costs (based on a market survey) of program components that occur in the market place. Prior to May 1993, DPS asked state agencies to negotiate an amount for each individual program component (e.g., for each direct-care staff position) of the programs it wanted to purchase from a provider using the CPC. The total of all these negotiated program components ultimately becomes the contracted program budget. State purchasing agencies

were also required to use the CPC when developing and implementing new program types. Effective May 21, 1993, DPS promulgated a CPC for fiscal year 1994 into regulations, 808 Code of Massachusetts Regulations (CMR) 3.00, and required all state agencies that have elected to use a component pricing methodology in pricing their social service programs to utilize this CPC.

In addition to changing how the state prices the services it purchases, DPS has also taken measures to control/regulate the state's POS system and to provide information to its users. For example, DPS promulgated 808 CMR 1.00 and 2.00, effective April 17, 1991,⁶ which establish uniform rules and procedures for the pricing, reporting, and auditing of social service programs purchased by state agencies and special educational services purchased by cities and towns. These regulations also establish uniform rules and procedures for the procurement of social services by state agencies. DPS has also issued General Conditions of the Master Agreement for Social Service Contracts under 808 CMR 2.00 (General Contract Conditions) for state contracts. These General Contract Conditions consolidate standard contract provisions for all social service programs that are made part of a provider's master agreement with a state purchasing agency. DPS also issues annual contract forms and instructions for state agencies to follow during their recontracting process and regularly holds informational seminars for auditors and representatives of providers and state purchasing agencies relative to various aspects of the POS system. Also, in October 1992, DPS issued a Purchase-of-Service System User Handbook (User Handbook) that describes in detail the principals, practices, and procedures involved in the POS system. DPS made this handbook available to all state agencies and contracted social service providers.

Despite DPS's efforts to implement reforms to the state's POS system, over the past several years there has been growing concern by state officials, private citizens, and other interested parties over the system and, in particular, on the activities of certain contracted social service providers. In an attempt to exercise more control over POS expenditures and to ensure the integrity of the state's POS system, several members of the state Legislature, as well as the OSA, filed legislation to further regulate this system. For example, during the 1993 legislative session, the state Legislature filed House bills No. 1378, No. 1380, No. 1381, No. 1383, No. 1385, No. 1386, and No. 2678 and Senate Bill No. 1664. These bills proposed to regulate the types of POS contracts that can be awarded, to prohibit members of the Board of Directors of contracted social service providers from directly or indirectly deriving financial benefits from their position, to limit the salaries of the executive directors of contracted social service providers, and to limit the terms of contracts with service providers. Additionally, House Bill No. 12, filed by the OSA during this legislative session, proposed requiring service providers to utilize a competitive bidding process when procuring program goods or services.

⁶ Sections of these regulations have been subsequently amended by DPS on several occasions, including August and November 1992.

On December 15, 1993 the state Legislature enacted Chapter 296 of the Acts of 1993, an emergency law entitled "An Act Further Regulating the Purchase of State Services." This law prohibits state agencies from awarding any "privatization contract"⁷ unless it meets certain contract requirements (e.g., is shown to be cost-effective). This legislation also imposes limits on the amounts that the state can reimburse service providers for the salaries of officers or managers and requires service providers to disclose in writing, in advance, all transactions between the contracted service provider and its related parties.

In addition to measures taken by the state Legislature to exercise more control over POS expenditures, in November 1992, the Secretary of EOHHS convened a POS Task Force to review the POS system. This task force was comprised of the Commissioners and their designees from the Departments of Public Health, Mental Health, Social Services, Mental Retardation, and Public Welfare. This POS task force was charged with:

- o Developing an accessible data base of services, providers, and clients;
- o Analyzing systems for monitoring and oversight; and
- o Making recommendations for reform.

On April 22, 1993, the POS task force issued its draft report. In this report, the task force concluded that the system currently used to purchase health and human services could be significantly enhanced in a number of key areas, as follows:

- o First, steps can be taken through the issuance of new regulations and policies to insure that contracted services are both more "quality focused" and accountable to taxpayers.
- o Second, specific oversight practices and reporting requirements can be put into place that would provide clear and current monitoring of the performance of providers.

Based on these conclusions, the task force made a number of short- and long-term recommendations (see Appendix E for a complete listing of these recommendations).

Subsequent to our audit field work, EOAF and EOHHS provided us with a draft report entitled "Strengthening the Commonwealth's Purchase of Service System." This report, which purportedly builds on the recommendations of the April 22, 1993 POS task force report, contends that the "partnership with private sector providers is a success," but adds that there are "substantial opportunities to further improve the way the Commonwealth purchases human services." This

⁷ Chapter 296 defines a privatization contract as an agreement or combination or series of agreements by which a non-governmental person or entity agrees with an agency to provide services, valued at \$100,000 or more, which are substantially similar to and in lieu of services theretofore provided, in whole or in part, by regular employees of an agency. Any subsequent agreement, including any agreement resulting from a rebidding of previously privatized service, or any agreement renewing or extending a privatization contract, shall not be considered a privatization contract. An agreement solely to provide legal, management consulting, planning, engineering, or design services shall not be considered a privatization contract.

report identifies some of the problems that exist within the POS system as determined by the administration and/or identified by OSA audits and proposes how the administration plans to deal or has dealt with these problems.

Some of the actions detailed in this report include moving the contracting process towards purchasing desired outcomes rather than inputs and processes, taking measures to strengthen the Boards of Directors of Service Providers, eliminating unacceptable related-party transactions, improving the private audit system, improving POS information technology, improving POS monitoring, and reducing the regulatory burden faced by contracted service providers. The measures the administration proposes to take and/or has taken, as detailed in this report, to address some of the problems that exist within the POS system are a positive first step towards improving the integrity of the system. However, more comprehensive measures than those detailed in EOAF's report are necessary to ensure that the POS system operates in the most efficient and effective manner.

Audit Scope, Objectives, and Methodology

The scope of our audit included an examination of certain aspects of the administration of the state's POS system during fiscal years 1988 through 1994 (through June 30, 1994). We examined the POS-related contract administration activities of five state agencies, Department of Youth Services (DYS), Department of Social Services (DSS), Department of Correction (DOC), Department of Mental Retardation (DMR), and Department of Mental Health (DMH), as well as various administrative and operational activities at 40 service providers⁸ for fiscal years 1989 through 1993 (see Appendix A). These five state agencies accounted for \$988 million (61%) of total POS-related expenditures during fiscal year 1993, while the 40 providers received over \$94 million in annual state funding this during fiscal year (this amount is for only 34 of the 40 providers we audited that had state contracts during fiscal year 1993). In selecting providers for review, we attempted to obtain a representative sample (i.e., providers located in different parts of the state and providing all types of services to the state agencies we audited) of the provider community that, with few exceptions, were receiving over \$1 million in state funds. Our audit was conducted in accordance with generally accepted government auditing standards (GAGAS) for performance audits issued by the Comptroller General of the United States and accordingly, included such tests as we considered necessary in the circumstances.

As noted in the Background section of this report, Chapter 138 of the Acts of 1991 dramatically changed the way the state administered its POS system by creating and designating one state agency, DPS, to bring about the administration's desired reforms to POS and to be responsible for managing and overseeing this system. At the beginning of our review, many

⁸ The majority of the service providers that we reviewed were randomly selected. However, several of our audits were conducted at the request of officials from DPS, state purchasing agencies, or other state agencies.

of the initiatives developed by DPS to meet its responsibilities as mandated by Chapter 138 were still being implemented. Consequently, the overall objective of our review was not to conduct an in-depth examination of every aspect of DPS and the POS system, since the system itself was in a dramatic state of change. Rather, our objective was to assess the system of administrative and accounting controls DPS had established relative to the operation of the POS system and, where necessary, to make recommendations on how to improve these controls. We believe that, through the establishment and implementation of an adequate internal control environment, DPS would be able to administer the POS system more efficiently and effectively.

Our specific objectives were to:

1. Obtain an understanding of the current POS system, including the responsibilities and activities of DPS and the system(s) of administrative and accounting controls that exist over the system, (i.e., all applicable laws, rules and regulations policies, procedures, and contractual and reporting requirements).
2. Review DPS regulations, procedures, and other information issued by the department and determine whether these regulations provide adequate guidance to state agencies and contracted service providers relative to POS activities.
3. Assess the effectiveness of the system of administrative and accounting controls established by DPS by:
 - a. Conducting audits at five state agencies to determine to what extent these agencies are complying with applicable POS laws rules, regulations, policies, and procedures.
 - b. Conducting audits at a sample of 40 contracted service providers to assess their business practices and determine the extent to which these service providers were complying with all applicable laws, rules, and regulations, as well as the terms and conditions of their state contracts. We also assessed the extent to which DPS's regulations and other administrative controls were ensuring that state funds were being properly safeguarded and expended in the most economical and efficient manner for their intended purposes.
4. Make recommendations, where necessary, on how the POS system can be improved.

To achieve our audit objectives, we first reviewed all applicable laws, regulations, policies, and procedures relative to the POS system. We also reviewed a number of reports relative to this system (see Appendix F), and publications issued by EOAF and DPS. These publications included, but were not limited to DPS's User Handbook, Uniform Financial Report (UFR) Audit and Preparation Manuals, Component Price Catalogues, Uniform Financial Statements and Independent Auditor's Report, Auditor's Compliance Procedures Supplements, General Contract Conditions, Audit Resolution Policy under 808 CMR 1.00, and UFR Review Procedures, as well as various other informational memoranda issued by the DPS and other agencies involved in the POS system during the period of our review.

We then conducted interviews with officials from DPS, EOHHS, EOAF, RSC, and the Office of the State Comptroller (OSC). The purpose of these interviews was to obtain an understanding of how the POS system operated prior to Chapter 138, how it currently operates, and the internal controls DPS has established over this system.

We also held discussions with officials and conducted reviews of the POS activities of five state agencies; DYS, DSS, DOC, DMH, and DMR. The purpose of these discussions and reviews was to obtain an understanding of how each agency administered its POS process from the point of determining its need for a specific service type, to advertising and awarding contract(s) for these services and monitoring and evaluating each contracted service provider's performance. In addition to holding discussions with these agency officials, at three agencies--DSS, DMR, and DMH--we found that the administration of POS-related activities was primarily done in a decentralized manner through area/regional offices rather than through the agency's central office. For these agencies we developed a standardized questionnaire that we distributed to the agencies' central office and to each of their area/regional offices in order to solicit information relative to POS activities. We then conducted site visits at each area/regional office to both substantiate the information provided to us in these questionnaires and to solicit additional comments and other information about the POS system from agency staff. Based on our audit work at each of these state agencies, we were able to determine the extent to which each agency was complying with the regulations, policies, and procedures established by DPS relative to the POS process. Also, in those areas where DPS has not issued specific regulatory or other detailed guidance on certain aspects of POS, (e.g., the monitoring of service providers) we assessed the effectiveness of each agency's administrative activities in ensuring that all social services purchased by it were reasonable, necessary, and adequately delivered.

Finally, we conducted performance audits at 40 contracted service providers to assess their business practices and their compliance with the terms of their contracts and all applicable laws, rules, and regulations. We used these audits to assess the effectiveness of the contract, fiscal, and programmatic monitoring and evaluation activities being utilized by state purchasing agencies, as well as the effectiveness of DPS regulations in this area.

Our special-scope audit did not include a comprehensive examination of other significant aspects of the POS system, such as the cost effectiveness of privatizing the provision of social services, or the qualifications of the staff at the state agencies or the service providers we audited. Also, our review was limited to certain expenditures made by state agencies from the state's "MM" subsidiary account (see Appendix D for a description of this subsidiary account and the object code expenditures subject to our review).

AUDIT RESULTS

The results of our review indicated that significant systemic, regulatory, and other operational/technical problems exist within the state's Purchase-of-Service (POS) system. These deficiencies are causing the POS system to operate at a less than optimum level, and in some instances have allowed the system to be abused. The results of our review appear in the following four major sections of this report:

SYSTEMIC PROBLEMS AT THE STATE AGENCY LEVEL

During our audit at five state agencies, we found deficiencies in the way these agencies administered their POS-related activities. These systemic deficiencies are detailed in Sections 1 through 4, below:

- 1. Inadequate Monitoring and Evaluation of POS Services Results in Inadequate Assurance That: All of the over \$1.6 Billion Spent on These Services is Expended in Accordance with the Terms and Conditions of State Contracts and Applicable Laws, Rules, and Regulations; Services Are Being Delivered in the Most Effective and Efficient Manner; the Desired Objectives Are Being Accomplished:**

The Division of Purchased Services (DPS) regulations, 808 Code of Massachusetts Regulations (CMR) 2.14, require state purchasing agencies to conduct annual reviews of each service provider's performance under their agreements. However, these regulations do not provide any detailed and specific guidance on how this objective is to be achieved. Rather, DPS has delegated the responsibility of establishing and implementing such monitoring and evaluation policies and procedures to the state purchasing agencies. We found the monitoring and evaluation activities being performed by the five state agencies that we audited to be deficient. For example, none of the five state agencies we audited had formally appointed a contract performance manager as required by DPS regulations to monitor provider compliance with the terms of their state contracts. Moreover, none of these agencies had developed and implemented formal written policies and procedures relative to the monitoring and evaluation of program services that correlate program inputs (funding) to process (program structure) and program outcomes (desired results) to determine whether programs are operating in the most effective and efficient manner. In effect, no statewide "system" of monitoring and evaluation exists (i.e., an overall established flow of information from the point of service up through management relating to service provider activities that is utilized by management to assess program services and evaluate the performance of service providers). Rather, the monitoring and evaluation activities being performed by the state agencies we audited were fragmented. Fiscal and programmatic monitoring activities being conducted by state agencies were not being coordinated; monitoring activities were not being routinely conducted; and any information being gathered by state agencies was not being synthesized and used effectively to evaluate program services or the performance of service providers. Also, our audit revealed that although service providers are required to submit to various state agencies an abundance of information relative to their activities, this information is in

some ways deficient (see Other Issues No. 2) and, in many cases, is not being used by state agencies to effectively monitor and evaluate their contracted service providers.

Because POS expenditures are not being adequately monitored and program services and service providers are not being adequately evaluated, the Commonwealth cannot be assured that all of the over \$1.6 billion it spends annually on POS services is being spent in accordance with the terms and conditions of state contracts or all applicable laws, rules, and regulations. In addition, the Commonwealth cannot be assured that program services are being delivered in the most effective and efficient manner.

Effective and efficient monitoring and evaluation activities (i.e., contract compliance, fiscal and programmatic monitoring, and program and service provider evaluations) are critical components in the state's POS system. Such activities serve to ensure that contracted service providers meet the terms and conditions of their state contracts; comply with all applicable laws, regulations, policies and procedures; and properly safeguard state assets. These activities also provide a mechanism for state agencies to ensure accountability, to assess the quality of services being provided, to identify and correct problems within their programs in a timely manner, and to determine whether the expenditures and services are accomplishing their objectives or whether new program types should be established or existing programs should be discontinued, expanded, or reduced in size.

The effects of inadequate program monitoring and evaluation have been discussed in numerous articles and publications. For example, an article published in the November - December 1991 Harvard Business Review relative to privatization of public services gives the following example of the effects of inadequate program monitoring:

The failure to hold private managers to agreed on results can be very costly. In 1963, "President Kennedy established Community Mental Health Centers to serve the mentally ill outside of large institutional settings. Osborne and Gaebler report that the National Institute of Mental Health gave millions of dollars to private firms to build and staff the centers but established no monitoring process to track the results. A Government Accounting Office investigation in the late 1980s revealed that many centers had converted to for-profit status and served only those who could pay. Others provided psychotherapy to patients without serious mental illnesses. Meanwhile, write Osborne and Gaebler, "perhaps a million mentally ill Americans wandered the streets sleeping in cardboard boxes or homeless shelters."

Prior to the establishment of DPS, the Executive Office of Human Services (EOHS)⁹ had established regulations, policies, procedures, and General Contract Conditions, which it included in its Purchase of Service Procurement and Contracting Manual (POS Manual). All state agencies within EOHS, as well as contracted service providers doing business with EOHS agencies, were required to follow the guidelines detailed in this manual. Regarding contract administration, EOHS's fiscal year 1989 POS Manual required all EOHS agencies to conduct three types of monitoring/evaluation reviews: internal, external, and program evaluations relative to their

 9 This agency's name was subsequently changed to the Executive Office of Health and Human Services (EOHHS).

purchased services. Specifically, Chapter 6, Section C(3) of EOHS's fiscal year 1989 POS manual required internal and external reviews, as follows:

Internal Review: Each purchasing agency will review all provider invoices and accompanying service delivery reports on a contract by contract basis each month (or as appropriate) to verify billing information.

Every three months purchasing agencies will review the following information as it applies to their programs: contract utilization, waiting lists and vacancies, changes in operational capacity, client eligibility, incident reports, staffing issues and required reports.

External Review (Site Visit): Each provider will be site-visited at least annually for a review of documents and for staff interviews by the appropriate purchasing agency staff. Document review should include: (a) review of client files for assessments, treatment plans, progress notes and other information required by contract, (b) review of changes in personnel policies or organizational structure, (c) review of personnel files for documents required by the EOHS General Conditions, (d) a review of all applicable licenses, certifications and accreditations, and (e) a comparison of invoices submitted by the provider for payment with documented events in the client files or on attendance sheets.

Following the site visit the purchasing agency shall complete a preliminary report. According to the EOHS General Conditions, a copy of this report shall be forwarded to the provider to allow for the opportunity to respond. Any written comments submitted within 15 days thereafter shall be attached to the final report.

Similarly, EOHS's POS manual required each state purchasing agency to evaluate each of the programs operated by contracted service providers. The primary purpose of conducting these program evaluations was to evaluate the effectiveness of the services being provided and to improve the delivery of these services. Regarding these evaluations, Chapter 6, Sections B and C, of EOHS's fiscal year 1989 POS Manual stated the following:

Each purchasing agency will submit an annual program evaluation plan to the EOHS Office of Contract Management in accordance with the timeliness issued by the EOHS.

All RFPs must include a summary of standards, policies and procedures regarding the evaluation of all purchased services. Performance criteria need to be identified by the purchasing agencies for all categories of services.

All provider proposal applications must identify measurable standards and performance criteria which can be used in evaluating the program. These standards and criteria should be included in Attachment A to the contract.

During each three-year contracting cycle each purchasing agency must evaluate all programs. In order to maximize resources and minimize duplication, evaluations should be conducted jointly with licensing agencies, accrediting organizations, and other agencies involved in purchasing services or reviewing the programs of the provider.

Finally, EOHS's fiscal year 1989 POS Manual required that all state purchasing agencies identify their program monitoring procedures in their Request for Proposals (RFPs) for contracted services as well as in Attachment C (statement of reports and applicable statutes, regulations, and manuals) of their service contracts. It should be noted that although these monitoring/evaluation reviews were required, several audits performed by the OSA and EOHS indicated that state agencies were not always complying with these requirements.

Under DPS, the state has taken a different approach to the monitoring and evaluation of POS-related services. For example, state agency responsibilities for monitoring and evaluating program services and service providers are less specific. Currently, regulations promulgated by DPS, 808 CMR 2.14(3), require purchasing agencies to "at least annually conduct a review of the provider's performance under the Agreement." However, DPS has not established or implemented formal written policies and procedures for a consistent comprehensive monitoring and evaluation process to be utilized by state agencies in their administration of POS contracts. Rather, DPS has delegated to the management of the purchasing agencies the responsibility of determining what is to be done during the conduct of these reviews and evaluations. For example, 808 CMR 2.14(1) promulgated by DPS states:

Contract Performance Manager Responsibilities: The Purchasing Agency shall appoint a Contract Performance Manager for each Agreement. The Contract Performance Manager shall be responsible for monitoring the Provider's compliance with all terms of the Agreement and for assuring satisfactory performance of all undertakings assumed by the Purchasing Agency in the Agreement.

Also, the general approach to monitoring and evaluation has shifted from state agencies being responsible for performing on-site monitoring and evaluation activities to state purchasing agencies relying more on information/reports provided to them from other sources. For example, providers who do business with the Commonwealth must currently make various disclosures and provide to their principal state purchasing agency (PPA)¹⁰ documents relative to their fiscal activities. These disclosures may include the following documents:

- o Where applicable, an Independent Auditor's Report in conformance with generally accepted government auditing standards i.e., performed in accordance with OMB Circulars A-128 or A-133;
- o Uniform Financial Statements and Independent Auditor's Report (UFR)¹¹;
- o Public Charities Reports (non-profit organizations only);
- o IRS 990 for nonprofit organizations and/or other tax filings; and
- o Certified disclosure of related-party relationships, board composition, and authorized signatures.

In order to become prequalified to do business with the state, these disclosures and documents undergo different levels of review by DPS, the PPA, and other state oversight agencies.

¹⁰ According to 808 CMR 2.02, the principal purchasing agency is the purchasing agency that contracts for the largest aggregate amount of state POS contract obligations with the provider, or as designated by the executive office that oversees the purchasing agency's operations, and is responsible for the annual prequalification determination for the provider.

¹¹ In accordance with Chapter 138, Section 99, of the Acts of 1991, with exception, every individual, group, partnership, trust, corporation, or other legal entity that owns or operates one or more programs of social, special educational, mental health, mental retardation, rehabilitative, vocational, employment and training, or older services program, including any program provided pursuant to Chapter 71B of the General Laws, but excluding any program or service that is reimbursable under Title XIX of the Social Security Act, which the Commonwealth of Massachusetts or any of its agencies or political subdivisions purchased services at any time during the provider's fiscal year must submit properly completed **Uniform Financial Statements and Independent Auditor's Report (UFR)** for that fiscal year.

In addition to these disclosures, state agencies may also require service providers to undergo reviews for such things as licensing, accreditations, certifications, consumer satisfaction surveys, and special investigations. Also, in many instances, clients will have case managers who are responsible for monitoring the services they receive. However, our audit revealed that although service providers are required to submit to various state agencies an abundance of information related to their activities, this information is deficient in some ways (see Other Issues No. 1) and, in most cases, is not being used by state agencies to effectively monitor and evaluate their contracted services and service providers. We also found instances in which state oversight agencies have identified serious problems with certain monitoring/oversight activities being conducted by state purchasing agencies. For example, a November 1992 report on DMR's Investigation Division issued by the State Inspector General concluded:

When there is a DMR policy on an investigations issue, that policy is almost always confusing and self-contradictory. There appears to be no DMR policy on investigator training, and as a result, investigators are ill-prepared to conduct proper inquiries into the serious abuse complaints they are assigned. The investigations manual and corresponding regulations DMR employs to govern its investigations are in fact DMH documents, and so can be subverted whenever a supervisor chooses. The organization, or command structure, of the Investigations Division is in flux, but all of the investigations directives issued since January, 1992 inexplicably incorporate management in a way that can only threaten the purity and strength of investigations. Furthermore, these directives conflict with each other, which must bewilder investigators in the field. DMR has failed to provide its investigators with CORI clearance, and the revisions to its background check policy on applicants contain contradictory statements regarding the importance of criminal records.

The Office of the Inspector General repeatedly was told by DMR employees that the Department has proven itself incapable of running an internal investigations system.

A brief description of the major monitoring and evaluation deficiencies we found at DPS and the state agencies we audited follows:

DPS is Unable to Effectively Monitor the Fiscal Activities of Contracted Service Providers: As of December 31, 1993, DPS had only four individuals in its Bureau of Audit to perform field audits/site reviews at the approximately 1,400 contracted service providers that provide services to state agencies. Rather, according to information published by DPS, the UFR is the primary vehicle used by the state to provide adequate oversight of provider agencies. According to DPS officials, the division performs three levels of reviews on a limited number of the UFRs they receive from providers, as follows:

- o **Preliminary Reviews:** These reviews are done on all UFRs to make sure all the required components of the UFR are submitted and were correctly completed. Also, in those instances where the service provider had an audit done in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-133, DPS's Bureau of Audit reviews this data for completeness and compliance with these filing requirements and determines whether a waiver to those requirements has been granted. The data from these reviews is entered into a data base and is used to generate a monthly report that DPS provides to all state purchasing agencies.

- o **Desk Reviews:** DPS targets a small percentage (less than 10%) of providers for desk reviews and has adopted the OMB A-128 procedures for the conduct of these reviews. The purpose of these reviews is to assess the quality of reports received to ensure that submitted reports meet applicable reporting standards and single audit (OMB Circular A-133) reporting requirements.
- o **Quality Assurance Reviews:** On a very limited basis DPS conducts quality control reviews. The primary purpose of these reviews is to assess the independent auditor's adherence to professional standards.

As noted above, although contracted service providers are required to annually compile comprehensive financial documents and to submit these documents to DPS, the division does not have the staff necessary to conduct the necessary comprehensive review of all of this information. In fact, less than 10% of the UFRs submitted by providers to DPS receive a desk review. DPS officials told us that they only conducted one quality control review during fiscal year 1993 on the approximately 900 complete UFRs they received. Moreover, we found that private auditing firms, in performing their UFR reviews, may not be identifying all of the deficiencies that exist within a service provider's operation, which should be reported to DPS and state principal purchasing agencies (see Other Issues No. 2). In addition to the reviews DPS conducts, the department also sends to each state purchasing agency a monthly report entitled UFR Filing Status Report. This report indicates whether DPS has received a provider's UFR, whether the UFR was complete, and whether there were audit findings based on the independent auditor's review of the provider. The report also indicates what corrective action must be taken to address these findings and whether a Corrective Action Plan (CAP) has been received from the PPA. Additionally, DPS also sends each state agency copies of the UFRs for those providers for which it is the PPA.

During our review, we asked DPS officials to provide us with information relative to CAPs established by state PPAs. The purpose of this request was to determine if state agencies were establishing CAPs and requiring service providers to meet the timelines established within each CAP to take the measures necessary to correct problems identified in their programs. As of June 30, 1994, DPS had not provided us with this requested information. However, a member of DPS's staff told us that during the past few fiscal years, state agencies were not very good at establishing and enforcing CAPs. However, this official stated that recently both DPS and other involved agencies have taken measures to improve this situation. We also questioned officials at the five state agencies we audited on how they use the monthly reports and UFRs they received from DPS. These officials told us that essentially they use this information to prequalify service providers for whom they are the PPA. They added that this information is not routinely analyzed or provided to their staff for use in monitoring or evaluating programs, program services, or service providers. These officials stated that they do not have the staff that would be needed to conduct comprehensive reviews of this information. For example, at DMR one individual is responsible for reviewing between 250 and 260 UFRs annually for the providers for which DMR has been designated the PPA. This function is performed at the central office level, and UFRs are sent to

the regional and area levels only if requested.

During our review, we examined the monitoring and evaluation activities conducted by the five state agencies we audited. The results of our review in this area follow:

Department of Youth Services: Our review indicated that although DYS has adequate controls to ensure the accuracy of its POS-related billings, it has not developed and implemented formal procedures for effectively monitoring and evaluating all of its program services. In addition, we found that DYS had no policies or procedures for formally appointing a contract performance manager for each agreement. Rather, according to DYS officials, contracting is a centralized process, and DYS's Director of Contract Administration assumes the responsibilities of contract performance manager for all DYS contracts.

DYS categorizes its programs as either community services or facility operations. Community service programs include group homes, special education programs, outreach tracking, and foster care. DYS officials told us that, prior to budget cuts DYS incurred during fiscal years 1991 and 1992, there were 14 monitors assigned to its five service regions to monitor and evaluate its community service programs. However, there are now only two staff members who perform these activities on community service programs statewide. In addition to being responsible for monitoring all of DYS's community service programs, these two individuals are also involved in preparing RFP information and participating in the selection process for contracted services and, therefore, their ability to effectively monitor these programs is further limited.

Although DYS has not developed and implemented standard written policies or procedures for monitoring community service programs, we determined that the DYS monitors visit all of DYS's community service programs each month and review the monthly service reports that are prepared by the service provider and sent to DYS's central office. These monthly reports include statistical data relative to such things as the number of youths served, DYS referrals to the program, and the number of discharges, terminations, and arrests. These reports also provide personnel breakdowns, training, and other contractual issues. Based on their site visits and reviews of the providers' monthly reports, these two monitors prepare quarterly reports that they provide to DYS's central office staff. In these reports the monitors evaluate such things as the accuracy and completeness of client files, the program's compliance with agency policies and procedures, and the level of services being provided in the program. However, these quarterly reports are based solely on the provider's program director's monthly reports and site visits, and no independent reviews of program services or operational aspects of the program are conducted by the monitors. Also, neither the program director's reports nor the monitoring reviews indicate that DYS is evaluating the quality of services being provided in these programs.

DYS's facility operations include all of its secure treatment facilities, shelter care units, and its forestry camp. Prior to the budgetary cuts DYS experienced during fiscal years 1991 and 1992,

each of DYS's facility operations programs was monitored and evaluated by a program review team made up of various DYS staff. In addition to their regular administrative responsibilities, facility administrators are now responsible for performing monitoring and evaluation activities at their facilities. Based on our review of the information maintained at these programs (e.g., minutes of facility administrator's meetings) we determined that none of these programs had formal monitoring and evaluation systems in place. Specifically, there were no written policies and procedures relative to the monitoring and evaluation of these programs, nor were there any monitoring and evaluation reports being generated by facility operations programs and sent to DYS's central office that could be used by DYS to assess the level and quality of program services. DYS officials told us that, in their opinion, they would need five additional staff positions to adequately monitor and evaluate their facility operations programs.

It should be noted that, in September 1993, the Commissioner of DYS and the Secretary of EOHHS convened a committee to conduct an assessment, identify service gaps, and make recommendations regarding DYS. On January 18, 1994, the committee issued a report that detailed its findings and recommendations. One of the committee's findings in this report was that DYS's information infrastructure has eroded:

The Department's capacity to ensure public accountability is limited. More than 60% of the agency's budget is allocated to contracted services however the Department has little capacity to monitor these services for adherence to contractual agreements. The Department's investigative unit was eliminated three years ago. This has undercut its ability to investigate deaths of youth in its custody, escapes, other incidents and allegations of abuse. The Department lacks a coordinated approach to clinical standards.

This report concluded that DYS needs the capacity to monitor both state and contract operations and to conduct investigations.

Department of Social Services: In addition to the contract monitoring and program evaluation activities required by state regulations, DSS is also required by its enabling statute, Massachusetts General Laws (MGL) Chapter 18B, to monitor and evaluate its social services. Specifically, Section 7(c) of this statute states that the Commissioner of DSS "shall develop and implement a comprehensive monitoring and evaluation system for all social services under the control of the department and shall collect the necessary program and fiscal data annually." However, our review revealed that DSS has not met its statutory obligations relative to monitoring and evaluating its program services. This conclusion is further substantiated by DSS's Deputy Commissioner of Administration and Finance in a January 11, 1993 memorandum to the Secretary of EOHHS, in which the Deputy Commissioner stated, in part:

Currently, DSS has no formal monitoring/oversight for provider quality of care or financial administration. . . at present, DSS has no standardized, regularly scheduled system to conduct either contract monitoring or contract evaluation. Site visits are performed on an as-needed basis, usually as a response to allegations of agency non-performance. . . at best, the Department is only able to complete the minimal vendor financial analysis required on a yearly basis through the prequalification process for the 406 providers for whom we are the Principal Purchasing Agency. The Department conducts no individualized contract financial analysis.

In regard to fiscal monitoring activities conducted by DSS staff, we interviewed officials from DSS's central and area offices and determined that service provider payment vouchers (PVs) are reviewed for accuracy and completeness, authorized, and processed in compliance with the Comptroller's Massachusetts Management Accounting and Reporting System (MMARS) Manual. However, we found that DSS does not have a system to determine whether clients actually received these services, whether service authorizations were consistent with the billings, or whether the services being delivered were in compliance with the terms of the contract. One of the reasons these problems exist is that all client records and service authorizations as well as service contracts are maintained at the area office level, while disbursements are processed at the central office level. There are no formal procedures to reconcile this information.

In addition to the problems we found relative to DSS's fiscal monitoring activities, we also determined that other monitoring and evaluation deficiencies existed. Based on information we received and analyzed from each of DSS's 26 area offices we determined that neither DSS's central nor area offices have developed or implemented policies or procedures to effectively monitor and/or evaluate program services. Specifically, we noted the following:

- o DSS does not appoint a contract performance manager for each contract to monitor program services as required by state regulations. Rather, DSS officials told us that the department's area office managers are informally responsible for monitoring and evaluating the performance of the service providers who are providing services in their geographic area. However, the majority of the area office directors with whom we spoke indicated that their work load prevented them from performing any program monitoring /evaluation activities.
- o DSS does not routinely conduct any on-site program evaluations, nor does it generate any type of monitoring reports or other information that can be used to evaluate both the performance of the service provider and the quality of program services.

Finally, we also point out that in 1992, Andersen Consulting, a private consulting organization, was asked by the Governor's Special Commission on Foster Care to undertake a review of the management and operation of DSS. In October 1992, Andersen Consulting issued its report that noted the following deficiencies in DSS's monitoring activities:

- o There is no review to determine whether the services are actually provided.
- o There is insufficient oversight and quality assurance to ensure, or even determine, that the services provided and performance of the contractor meet quality and performance standards.
- o There is an unsatisfactory process for ensuring that the mix of services provided meets the needs of the consumers of those services.
- o These three deficiencies result in a purchase of service system which the agency is failing to control. The providers are on an honor system. The agency simply authorizes payment for what the contractors bill, without review to assure the billing was correct or that services were actually provided. This results in high and widespread potential for fraud, waste, and abuse in the purchase of services.

In this regard, DSS's Deputy Commissioner stated in a January 11, 1993 memorandum to the Secretary of EOHHS that the department was in the process of developing a comprehensive monitoring system that would include administrative (fiscal), programmatic, and licensing (health and safety) components. As of June 30, 1994, DSS had established an internal audit unit. However, according to a staff member, this unit was in its infancy stage and was only doing internal reviews of DSS's operation.

Department of Correction: Our audit of DOC revealed that its monitoring and evaluation activities over contracted service providers was inconsistent and varied depending upon the individual contract. DOC's largest POS contract is with a company called Emergency Medical Services Association, Inc., (EMSA), which provides health care services to DOC inmates under a three-year \$16 million contract. Our review of DOC's monitoring/oversight activities relative to its EMSA contract revealed that DOC had established formal fiscal and programmatic monitoring and evaluation activities, which included the performance of comprehensive quarterly reviews and the development and implementation of corrective action plans if problems are identified during the review of this contract. However, the adequacy of DOC's monitoring and evaluation activities relative to this contract is currently being examined under a separate audit (No. 94-6005-2) being conducted by the OSA.

We found DOC's review of provider invoices of other POS contracts to be adequate while other aspects of its monitoring and evaluation systems were less formal and inadequate. The specific problems we found with DOC's monitoring and evaluation activities are as follows:

- o DOC did not have written policies, procedures, or guidelines relative to the monitoring and evaluation of its programs and/or contracted service providers.
- o There was no documentation to substantiate that DOC had evaluated the performance of its contracted service providers as required by 808 CMR 2.14(3)
- o There was no documentation to substantiate that DOC conducts routine, on-site reviews of its service providers. Although DOC does have internal audit staff, the two individuals who are on this staff told us that the DOC has not conducted on-site audits or reviews of service providers for several years.
- o DOC had not formally appointed a contract performance manager in accordance with 808 CMR 2.14(1). Rather, DOC officials told us that there are certain divisions within DOC that oversee a particular type of program and are therefore responsible for meeting the requirements of the Contract Performance Manager detailed in 808 CMR 2.14(1).

In response to this issue, DOC officials agreed that DOC's POS monitoring and evaluation activities, and in particular, DOC's programmatic monitoring activities are inadequate, and stated that they will take measures to address this problem.

Department of Mental Retardation: DMR's central office does maintain a data base of program budgets. However, there is no documentation to substantiate that it uses this data to perform any kind of financial analysis of program costs. Further, DMR's central office has not developed and implemented standard POS monitoring and evaluation policies and procedures for its five area offices. Rather, DMR's administration of its POS process is decentralized, with each

of the department's five area offices being responsible for developing and implementing their own POS monitoring and evaluation systems.

As a result, we found that the monitoring and evaluation activities being performed by DMR varied between regions and, in some cases, varied between area offices within the same region. For example, two regions appointed contract managers for each contract at the regional level, while DMR's other three regional offices delegated contract management responsibilities to their area offices. We also found no uniform process for assigning contract managers and no departmental policy indicating what the responsibilities of the contract managers are for overseeing contracts.

At each of the regional offices we visited we found that office staff had not established and implemented specific POS monitoring and evaluation policies and procedures. Rather, these staff members told us that they were performing a variety of formal and informal monitoring and evaluation activities that they believed were effective. These activities included quality assurance evaluations that review the ways that providers serve individuals with varying needs in day and residential programs; internal self-evaluations that some providers perform; consumer satisfaction surveys, which are performed by a contracted research agency on a limited basis; individual service plans, which are prepared at the area office level for each individual being served by DMR; and an accreditation/certification process for all intermediate care facilities that assesses compliance with federal Medicaid regulations, licensing of residential and day services providers, and citizen monitoring that are scheduled for a limited number of providers each year, depending upon region. Although DMR's regional and area offices may be performing a variety of monitoring and evaluation activities, any information they derive from these activities is not routinely documented, synthesized, and evaluated by area, regional, or central office staff and used to assess either the adequacy and effectiveness of a program or the performance of service providers.

DMR officials stated that a new Quality Enhancement Survey Tool (QUEST) currently being developed will be implemented in January 1994. This new system will assign scores to outcome measures to provide an overall rating for a provider. DMR believes this new system will provide the synthesis of data and overall assessment ratings, which is not currently available. As of the end of our audit field work at DMR, this system had not been implemented and, therefore, we were not able to assess its effectiveness. However, it is our intention to review the QUEST system during our next audit of DMR.

Department of Mental Health: Our review disclosed that DMH had not developed and implemented standard monitoring and evaluation policies and procedures for its contracted service providers. Since DMH's process for administering its POS contracts is decentralized, we found that each of DMH's seven area offices had the responsibility of developing and implementing its own monitoring and evaluation system. We determined that DMH's area offices properly reviewed service provider payment vouchers for mathematical accuracy, completeness, and

authorization. For those contracts that are on the state's Ready Payment System, the area offices were found to have conducted reconciliations of amounts billed to the previous amounts paid. Also, case managers within each area reviewed client attendance records in order to verify the providers' charges.

Although there is no formal central office policy for appointing a "contract performance manager" for each agreement as required by 808 CMR 2.14(1), we found that the area directors informally assign related monitoring responsibilities to various area office personnel. According to area office personnel, various monitoring activities take place for each contract at different times during the year. These activities include, but are not limited to:

- o Human rights program compliance survey,
- o Citizen's quality of life review for private hospital acute units,
- o Incident reports,
- o Licensing site surveys, and
- o Residential services validation surveys.

Although such individual monitoring activities may take place for most contracts, we found inconsistencies between area offices in regard to exactly what activities were performed as well as what documentation was maintained. Further, the information/data that was derived from these monitoring activities was never synthesized by any of the area offices in order to develop an overall annual assessment and evaluation of service provider performance.

Recommendation: Currently, the POS system needs an effective, efficient, uniform, and consistent system for monitoring and evaluating POS-related activities. Although state agencies are conducting various types of reviews, the procedures for all monitoring activities (e.g., licensing, quality assurance reviews, contract monitoring, program evaluations, and audits) should be more standardized and coordinated. Also, the results of these reviews should not only be retained at the area office level as was disclosed during our audit of some state agencies, but rather should be synthesized and provided to middle and upper management staff so that proper policy and operational decisions can be made. Any improvements made to the DPS' UFR reporting and review process, as recommended in Other Issues No. 2, will enhance the state's ability to monitor the financial activities of service providers (program inputs). However, as the state begins to utilize other types of contracting that will involve focusing on program outcomes, DPS, in conjunction with state agencies who utilize POS-related services, should establish procedures or methods that would effectively facilitate the correlation of program inputs to processes and outputs/outcomes to determine whether the desired program results were obtained in the most economical and efficient manner. Information from these monitoring activities should be synthesized and provided to the appropriate staff to assess whether each program or program type should be continued, discontinued, expanded, or reduced in size, as well as to assess the effectiveness of each program and the performance of each service provider. Accordingly, we recommend that DPS take the following preliminary measures:

1. Amend its current regulations to contain specific minimum standards for the monitoring and evaluation activities that state agencies need to perform. These activities should address all areas of program monitoring/evaluation, including data collection, analysis and synthesization, communication of results, and corrective action measures. For example, in regard to program evaluations, these regulations should prescribe the frequency, (e.g., annually) of these evaluations and should be based on pre-established performance indicators, as defined in the contracts, that can be measured and that relate to the stated goals and objectives of the program and to specified program outcomes. Each state purchasing agency should be required to submit an annual program evaluation plan to DPS subject to DPS's approval. Each program evaluation plan should become an integral part of the state purchasing agency's contract procurement/renewal process. State agencies should ensure that monitoring forms are developed and monitoring/evaluation teams collectively possess the necessary skills to accomplish the goals and objectives of the agency's monitoring activities.
2. DPS should require state agencies to submit the results of their monitoring activities to it for the purposes of establishing a POS data base. This database could be used to develop a POS related information infrastructure that could be used by all state agencies in the contracting process. Such a data base should not only be used to monitor each provider's compliance to the terms and conditions of their contractual agreements, but should also be used to support and enhance the delivery of program services.
3. Continue to provide training to state agencies relative to effective monitoring and evaluation activities.
4. DPS should require state agencies to formally appoint and identify contract performance managers for each state contract. State agencies should also be required to identify specific duties and responsibilities to be performed by this individual.

In addition to the operational/procedural changes recommended above, the lack of resources to effectively implement efficient and effective monitoring and evaluation systems needs to be addressed. As such, we believe that the state Legislature should consider taking the following measures:

1. Designate a certain portion of each state agency's annual appropriation to fund program-related monitoring and evaluation activities.
 2. Provide sufficient funding to DPS so that it can (1) implement an effective UFR review process; (2) develop, implement and oversee/coordinate a statewide POS-related program monitoring system and data base; and (3) increase training on efficient and effective monitoring and evaluation activities.
2. **Inadequate Program Budget Negotiation and Budget Monitoring Activities by State Agencies Resulting in a Lack of Assurance That Social Service Programs Are Being Properly Funded and Administered**

We found significant problems with the contract budgeting/negotiation and budget monitoring process used by state agencies in funding their POS contracts. Specifically, program budgets are dysfunctional in that they are used only to establish the unit rate of payment for program services and are not used by state agencies to monitor and evaluate program costs or services. Also, none of the state agencies we audited had developed and implemented formal training programs relative to contract negotiations. As a result, the Commonwealth cannot be assured that social service programs being purchased by state agencies are being properly funded or administered. In fact, several service providers we audited criticized the contract budgeting

process stating that they were given a bottom line figure by their state purchasing agency and told to back into this figure with a program budget. However, other providers clearly received funding far in excess of their programs needs. As a whole, we found that the POS provider system may be experiencing financial deterioration as a result of these budgeting practices. For example, according to information provided to the state Legislature by EOHHS in May of 1990, the median return-on-asset rates and surplus revenue percentage for the nonprofit organization for which EOHHS had data, was during fiscal year 1989, 6.6% and 2.7%, respectively. Based on information maintained by EOHHS for fiscal year 1993, the median return-on-assets and percent surplus fell dramatically to 3.2% and 1.3%, respectively.

Currently, state purchasing agencies utilize several methods to pay for POS-related services: class-rate, cost-reimbursement, accommodation rates, performance-based contracts, vouchers, and non-negotiated and negotiated fee-for-service (unit rate) contracts. Under class-rate contracting, the state Rate Setting Commission (RSC), primarily using historical cost information that it receives from service providers, establishes a standard or class rate of reimbursement for each particular type of service (e.g., physical therapy). All providers are paid this class rate for each unit of service they provide. Class-rate contracts are currently used only for certain types of services (approximately 10%), primarily those that are Medicaid-reimbursable. Under cost-reimbursement contracts, providers are reimbursed for the costs they actually incur in providing the contracted services up to a specified maximum amount. Typically, state agencies award cost-reimbursement contracts to providers for services in times of emergencies or when the state purchasing agency cannot readily determine the level of services it will ultimately need. Accommodation rates are used to ensure that services are available regardless of the actual utilization rate (e.g. to ensure that beds are available for battered women in locations throughout the state). The state pays based on the availability of the services, rather than on the amount of service used. In performance-based contracts, the agency and provider agree on the results to be achieved, and payment is linked directly to the achievement of the desired outcome. Currently, less than 10% of all POS contracts are performance based. In voucher purchases, clients choose their own provider, and the Commonwealth reimburses the provider for the agreed-upon amount. Clients ensure their individual needs are met and may change providers if not satisfied. The value of a voucher may be either set at a fixed sum to each consumer in advance or negotiated with each provider directly. Under non-negotiated unit-rate contracts, a provider is paid a per-unit rate of payment established by DPS for a specific program based on the costs of the program. This type of contracting is used when procuring special education services (as defined by the Department of Education Chapter 766 Regulations that were promulgated under MGL Chapter 71B). Finally, the most common form of contracting used by state agencies when procuring social services (approximately 50%) are negotiated unit-rate contracts. Under the terms and conditions of negotiated unit-rate contracts, a service provider agrees to furnish a specified number

of units of service, as defined by the state purchasing agency within the contract. The service unit can be a measure of time, (e.g., an hour of training) or the completion of a prescribed procedure, (e.g., a client's individual education plan). As compensation for providing these units of service, a provider receives a unit rate of payment that is determined by dividing the agreed-upon total program budget (which appears as Attachment "B" to all negotiated unit-rate POS contracts) by the total units of service to be provided. For example, if a budget for a program indicated that total negotiated expenses for the program during the course of the contract year would be \$100,000, and the provider was to provide 1,000 units of service, the unit rate of payment would then be \$100 per unit (\$100,000 divided by 1,000 units).¹²

Currently, in the 808 Code of Massachusetts Regulations (CMR) 2.00, DPS details the contracting and contract-renewal process that all state agencies and contracted service providers must follow. For negotiated unit-rate contracts, these regulations require service providers to develop and submit a program budget to the funding agency for review and approval. According to contracting instructions issued by DPS, the budget submitted by service providers to state agencies should accurately reflect anticipated program costs and revenues. An effective and accurate program budget and budgeting process serves many purposes, including the following:

- o Helping plan the efficient and effective utilization of limited program resources.
- o Quantifying objectives and the means selected for achieving them by relating expected occurrences to the resources available.
- o Forcing consideration of all the tasks needed to meet the goals of each organizational unit.
- o Providing a means of communicating detailed plans to all concerned.
- o Serving as a basis for performance control through comparisons of actual with budgeted data, which provides a basis for analysis of variations from plans that can signal the need for corrective managerial action.

Typically, state agencies award contracts to service providers for a five-year period. The terms and conditions of these contracts are negotiated between the state agency and the service provider during the contract negotiation phase and are essentially carried forward, or "rolled over," for the remainder of the five-year contract period. However, every year state agencies and service providers are supposed to review the terms and conditions of these contracts and determine whether funding should be reauthorized. Based on this evaluation, the state purchasing agency can (1) terminate the contract for cause (e.g., inadequate funding), (2) roll over the contract with no changes, or (3) renew the contract but amend its terms and conditions based on changes in the programmatic and/or fiscal aspects of the program that have occurred or are anticipated to occur.

¹² In practice, state agencies accelerate the rate of reimbursements to service providers by dividing the agreed-upon program budget by 85% of the units of service to be provided. In this example, the actual unit rate of compensation would be \$100,000 divided by (1,000 x .85) = \$117.65, up to the \$100,000 maximum obligation.

During the contract renewal and amendment process, state agencies should review the provider's most recent financial reports and analyze and compare actual and budgeted program expenses. This review would allow the purchasing state agency to better understand program costs and negotiate fair and equitable program budgets.

During our review of the budgeting process used by the state agencies, we found significant problems with the state's budget/negotiation and budget monitoring processes relative to negotiated unit-rate contracts. These problems are detailed in Sections A and B and in the specific agency discussions that follows:

A. Program Budgets Are Dysfunctional and Are Not Being Used by State Agencies to Monitor and Evaluate Program Costs or Services: According to DPS officials, program budgets for negotiated unit-rate contracts are used only to establish unit rates of payment. Subsequent to these rates being established, providers are not specifically required to stay within the expense amounts established for each of the items in their program budgets and are not required to amend their state contracts even though they may decide to shift funding between budgeted line items. These officials told us that component pricing (CP) of contracts is being phased in so that state agencies can focus on ensuring that program services are being provided rather than "micro-managing" the fiscal aspects of their contracted service providers. This concept of focusing on services rather than actual program costs has been codified by DPS in 808 CMR 3.00, which states that, by virtue of using component pricing, program budgets will represent a "fair" price for the program being purchased. Therefore, a financial review of a program priced by utilizing the CPC should be "bottom line driven" (i.e., should not be concerned with comparing line-by-line actual-to-budgeted program costs).

While component pricing may represent, in the administration's opinion, an easier and fairer way of pricing POS contracts, according to DPS officials, only approximately 10% of the total POS contract dollars awarded during fiscal year 1993 were priced using component pricing. Although CP has not been fully implemented, the state agencies we audited appeared to be applying the concepts of budgeting and budget monitoring as they apply to component pricing, (i.e., accepting that the program is fairly priced so there is no need to monitor budgeted versus actual program costs) to all POS contracts. As previously noted (in System Problems at the State Agency Level No. 1), any monitoring and evaluation systems that the state agencies we audited had developed and/or implemented were for the most part inadequate, making it all the more important for agencies that do not utilize component pricing to conduct some type of program budgetary review.

Additionally, although DPS in its User Handbook does provide some guidance on budgeting, neither it nor the state agencies we audited have developed and implemented specific budgeting and budget-monitoring guidelines to use for those programs that were priced without using CP to ensure that these programs are fairly priced and properly administered. Also, except for DYS, none of the state agencies routinely reviewed their providers' most recent UFR to compare actual

versus budgeted program expenses where applicable during their contract negotiations. For example, DMR officials told us, UFRs that are provided to DMR's central office are made available to regional office staff only upon request. Regional staff told us, however, that even if this information was made available to regional and area office staff, it is of limited use because it is outdated (sometimes 18 months old) and does not provide sufficient detail on a program-by-program basis (see Other Issues No. 2) and the information on administrative overhead costs are not specifically listed, so they cannot be evaluated and used in the contract negotiation/renewal process. In fact, regional office officials told us that area and regional office staff only review administrative costs if the percentage to the total budget appears to be in excess of the CPC.

Regarding this matter, DSS's Deputy Commissioner for the department's Division of Administration and Finance stated the following in a January 11, 1993 memorandum to the Secretary of EOHHS:

- o Currently, the Department of Social Services contracts with over 500 vendors. Nearly 4,000 programs are purchased from these vendors. The magnitude of this contracting activity coupled with reduced administrative staff does not afford the Department the ability to oversee the provider's financial administration of its contracted programs.....In the past, the open bid process and the yearly renewal process required vendors to complete prior year program expenses and projected program year costs. This allowed area administrative staff to conduct a yearly financial analysis on prior year costs and integrate the results of that analysis into projected year program costs. Unfortunately, with the push toward paperwork reduction, the emphasis on bottom line program budgeting and towards programmatic outcomes, the elimination of the RSC 600B, and the development of standardized simplified program budget forms, the information utilized for program budget analysis and oversight was eliminated.

As a result of these problems, state agencies may be overfunding or underfunding programs. For example, at one for-profit service provider we audited, we found that the agency did not indicate in its program budgets to state agencies the amount of profit it was making on its state contracts, nor did DMR, the provider's principal state purchasing agency, require it to disclose this information on its program budgets. Rather, provider officials told us that they realized profits by requesting and receiving funding from DMR for levels of services that they believed to be "optimal" (i.e., costs that the service provider believed could potentially be incurred in the program based on a worst-case situation), but not necessarily what the service provider actually expected to be incurred based on the program's historical costs. These optimal costs would represent the maximum levels of both direct and indirect costs that the service provider believed will be incurred in the program. If the provider did not experience a worst-case situation, this type of budgeting would allow the provider to realize unbudgeted profits. In addition, officials from DMR told us that they negotiate contracts without knowing the program's prior year actual costs. As a result, between fiscal years 1988 and 1993, the provider received approximately \$1.3 million in unbudgeted, undisclosed profits from its state contracts, a significant portion of which (over \$500,000) was expended on non-program-related items such as a \$280,000 bonus to the provider's Executive Director during fiscal year 1992, \$55,272 on luxury automobiles (e.g., a Porsche

944 Coupe) and \$3,247 on four season tickets to Boston Red Sox games. In fact, we found that during fiscal years 1990 through 1993, the total costs in seven of seventeen programs actually decreased while the funding DMR provided to this agency for these program costs increased.

B. Inadequate Training Relative to Contract Negotiations: According to DPS regulations and guidelines, all POS contracts are to be priced based on open and fair negotiations between the state purchasing agency and the contracted service provider. DPS User Handbook states, in part:

The pricing process for all POS programs subject to 808 CMR 1.00 (except special education services from MGL Chapter 71B approved private schools) is based on open negotiations between the State Purchasing Agency and the Provider. The Division's primary role is to establish the rules under which such negotiations occur.

Moreover, DPS's User Handbook provides the following general guidance on contract negotiations:

- o-- Programs which are competitively procured under the principles of Component Pricing must be negotiated within the pricing parameters of the Component Price Catalogue.
- o-- When developing and negotiating a program budget, both the Provider and the Purchasing Agency should first review the program narrative. Everything that is needed to operate a given program should be articulated in the program narrative and should be carried over onto the budget document.
- o-- Purchasing Agencies must balance their role as prudent buyers with the acknowledgment that purchase-of-service programs should be priced fairly. One of the guiding principles of POS reform is fair, market-based pricing, which was developed in part to support the long-term stability and viability of the community service system.
- o-- In negotiating a budget for an existing program, the Purchasing Agency may review the Provider's most recent UFR to compare actual costs to projected expenses. In the case of costs listed on the Agency Administration Support Allocation line of the Attachment B, the Purchasing Agency may, at its discretion, request supporting documentation for those costs.

However, despite this guidance from DPS, we found that none of the five state agencies we audited had developed or implemented contract negotiation guidelines or procedures to follow when either initially negotiating or renewing POS contracts. Further, none of these state agencies were providing any significant staff training relative to contract negotiation. Moreover, officials at some of the DMH area offices we visited told us that they were instructed by their central office staff not to "bother" the service providers by requesting specific fiscal or programmatic information during the contract negotiation process. As a result, state agency staff may not have the knowledge and skills or information necessary to negotiate complex contracts such as those awarded for POS services. Without adequate training and information, contract budgets may be more reflective of the negotiating skills of the service providers than the actual needs of the program. In fact, we found several instances where negotiated contracts contained questionable program costs. For example, during fiscal years 1991 and 1992 one service provider we audited, included in its program budgets to three state agencies, MRC, DMH, and DMR--line-item budgets for client transportation totaling \$68,024 that it subsequently received through its

contract billings to these agencies. However, during our audit, we determined that this service provider does not routinely provide transportation for its clients. Rather, the clients which this provider serves are responsible for their own transportation to and from program sites. We also reviewed a random sample of 29 fiscal year 1993 contracts, which totaled \$24,685,572, awarded by 10 of the state's largest service providers. Based on our review, we determined that at least \$1.9 million (approximately 8%) of the costs in these contracts were duplicative, (e.g. the provider was being reimbursed under an administrative allowance and also as direct program expenses for such things as secretarial and EDP support). This is a clear indication that state agencies are not negotiating equitable POS contracts.

Some of the service providers we audited complained about the fabricated nature of the budgeting process that, rather than negotiating line-item expenses, establishing a budget, and ultimately determining an equitable unit rate of payment for program services, state agencies would often give them a bottom line figure and tell them to back into this figure with a budget. This fact is further substantiated in a July 1, 1994 letter from a service provider to DPS's Director of Pricing Bureau in which the service provider states:

Since component pricing has never been funded, I do not understand why we are required to use it. In practice, we create imagined offsets to fictitious wages to complete contracts still being funded at 1987 levels.

In addition, the Executive Director of the Massachusetts Council of Human Service Providers, Inc., an organization to which many service providers doing business with the state belong, stated in a recent editorial:

The old reality was that the state would under-fund contracts and get providers and advocates to mobilize their forces to persuade a legislature responsive to the community care movement to adequately fund them. For a long while this humanitarian shell game worked.

The emerging reality is that community care is nearly universally accepted but the political effectiveness of the community care movement has waned and can no longer persuade the legislature to make up for state funding shortfalls . . . private providers should be encouraged, not required by the contracting agency, to supplement state contract funding.

Finally, state officials have referred to the budgeting process as a negotiating game whereby providers continue to back into budgets. This type of top-down budgeting runs contrary to standard budgeting practices and creates ineffectiveness in the provider system by either under or overfunding providers for contracted services. In fact, there are indications that this type of budgeting practices may be causing significant financial deterioration of providers within the POS system. Specifically, on May 10, 1990, the Secretary of EOHHS submitted to the House and Senate Committees on Ways and Means a report on the financial position of the operation of 252 (approximately 20%) of the 1,300 POS service providers contracting with EOHHS during fiscal year 1989. This report indicated that two key financial ratios used to measure the financial health of an entity, the median return-on-assets ratio (net income divided by average total assets) for

these providers was 6.6%, while the median surplus revenues was 2.7%. However, based on the fiscal year 1993 prequalification information maintained by EOHHS for 850 EOHHS human service providers, these financial ratios declined dramatically to a median return-on-assets ratio of only 3.2% and surplus revenue percentage of 1.3% during this fiscal year. Also, this type of budgeting creates a disincentive for providers to assess their program service needs and modify their program models to make them more effective, since they know that they are going to get the same funding regardless of these needs. An example of this problem at one of the service providers we audited follows.

Ineffective Contract Monitoring and Budgeting by Community Connection Inc., (CCI) Resulted in as Much as \$99,416 in Excessive Program Funding: During our review we compared the actual costs CCI incurred in its Dennis and Fall River Workshop Programs during fiscal year 1991 to the budget requests CCI submitted to DMR to fund these programs. Both of these programs have been "level-funded" by DMR for several years, with the maximum obligations being rolled over year to year.

Our review revealed significant variances between the amounts that DMR budgeted and the expenses it actually incurred in these programs for all major expense categories. Specifically, in its Dennis Workshop Program, CCI's actual expenses were \$26,810 less than what was funded by DMR, and CCI received a total of \$19,855 more in revenue than it reported in its budget to DMR as offsets to program costs. As a result, DMR provided CCI with as much as \$47,222 (20%) more in funding than what was actually needed to provide services to its clients.

Similarly, for its Fall River Workshop Program, CCI incurred \$74,718 more in expenses than was reimbursed by DMR, but received \$127,469 in other revenue (program offsets) that it did not report to DMR. As a result, DMR provided CCI with as much as \$52,751 (11%) more in funding than what was actually needed to provide services to its clients.

CCI officials stated that, although they have tried to annually renegotiate the terms and conditions of these contracts with DMR, each year DMR simply rolls these contracts over and tells CCI what the maximum obligation of these contracts will be. CCI officials stated that they are therefore forced to develop program budgets based on this "bottom-line" maximum obligation figure and simply plug in numbers to meet this maximum obligation. As such, CCI officials stated that these program budgets did not reflect accurate estimates of program expenses or revenues. It should be pointed out that despite the significant variances between the budgeted and actual revenues and expenses we found in the contracts noted above, DMR provided the same funding to these programs during fiscal year 1992.

The following is a brief summary of the contract budgeting/negotiating problems we noted at each of the five state agencies we audited.

Department of Youth Services: Our review indicated that DYS's central office has not established formal written guidelines or policies and procedures relative to negotiating program budgets for either new contracts or contract renewals. Also, DYS's central office does not provide

staff training pertaining to negotiating contracts. However, DYS officials told us that the manageable size of the POS program at DYS (approximately 26 vendors providing 73 contracted programs during fiscal year 1993) allows the Director of Contracts to participate in all the negotiations for both new contracts and contract renewals. The Director of Contracts reviews all the UFRs for which DYS is the PPA and obtains copies of the UFRs from DPS for all of the remaining providers with which they do business. The Director of Contracts reviews the UFR data and uses this information during the negotiation process. The other individuals involved in the negotiation process could include a regional director, program monitors, case workers, and facility administrators. These individuals would be more focused on the program components than on budget detail. The Director of Contracts indicated that the UFR review was very important and helpful in negotiating a fair contract and that more budget detail was being collected by the contract office for future use.

Department of Social Services: During our audit of DSS we requested information relative to DSS' contract negotiation and contract renewal process from officials at DSS's central office and its 26 area offices. Based on our review of this information, we determined the following:

- o DSS's central office has not developed or implemented formal contract negotiation guidelines for its central or area office staff to follow when initially negotiating or renewing service contracts.
- o Neither DSS's central nor area offices provide regular training relative to contract negotiations and contract renewals to applicable staff members.
- o None of DSS's area offices compare actual to budgeted program costs when negotiating contract renewal and most area offices stated that they are not provided with copies of financial reports/UFRs from DSS's central office for the providers that they contract with.

In this regard, DSS's Deputy Commissioner for the department's Division of Administration and Finance stated the following in a January 11, 1993 memorandum to the Secretary of EOHHS:

Currently, the Department of Social Services contracts with over 500 vendors. Nearly 4,000 programs are purchased from these vendors. The magnitude of this contracting activity coupled with reduced administrative staff does not afford the Department the ability to oversee the provider's financial administration of its contracted programs.

In the past, the open bid process and the yearly renewal process required vendors to complete prior year program expenses and projected program year costs. This allowed area administrative staff to conduct a yearly financial analysis on prior year costs and integrate the results of that analysis into projected year program costs. Unfortunately, with the push toward paperwork reduction, the emphasis on bottom line program budgeting and towards programmatic outcomes, the elimination of the RSC 600 B, and the development of standardized simplified program budget forms, the information utilized for program budget analysis and oversight was eliminated.

Department of Correction: During our audit of DOC we determined the following:

- o DOC has not developed or implemented formal contract negotiation guidelines to follow when initially negotiating and/or renewing social service contracts.
- o DOC does not provide regular training to staff members relative to contract negotiations.

According to DOC officials, given the size of DOC, the Department's Contract Manager is primarily responsible for negotiating contract budgets, as well as processing contract renewals. Except for those providers for which DOC acts as the PPA, DOC does not receive financial information (UFR) that would allow it to compare actual versus budgeted program costs. As a result, DOC generally relies on the Contract Manager's experience and knowledge in negotiating budgets and renewing contracts.

Department of Mental Retardation: We found that DMR's central office has not established any formal written guidelines or policies and procedures relative to negotiating program budgets for either new contracts or contract renewals. Also, DMR's central office does not provide staff training in these areas.

The responsibility for negotiating contracts has been delegated by DMR's central office to its five regional and 27 area offices. According to the DMR regional and area staff with whom we spoke, the central office determines the amount of funding that will be provided under each of the area office's contracts before contract negotiations begin, and area office staff are expected to obtain, through negotiation, the maximum amount of program services they can for this predetermined amount.

We also found that, during the contract renewal process, UFRs that are provided to DMR's central office are made available to regional office staff only upon request. Regional staff told us, however, that even if this information was made available to regional and area office staff, it is of limited use because it is outdated (sometimes 18 months old) and does not provide sufficient detail on a program-by-program basis (see Other Issues No. 2) and the information on administrative overhead costs are not specifically listed, so they cannot be evaluated and used in the contract negotiation/renewal process. In fact, regional office officials told us that area and regional office staff only review administrative costs if the percentage to the total budget appears to be in excess of the CPC.

Finally, officials from DMR's regional and area offices told us that they do not compare actual to budgeted program costs in their contract renewal process. They stated that this type of analysis would be done only if they had problems with a specific provider.

Department of Mental Health: During our review of documentation at DMH's central and seven area offices we found a number of problems with the methods used by DMH to establish and monitor program budgets. First, DMH's central offices and its seven area offices have not developed formal written procedures relative to negotiating and/or renewing POS contracts. Also, DMH does not provide training relative to these activities to its staff. According to several DMH Area Operation Managers with whom we spoke, DMH's Central Office does not make service provider financial information available to the area offices during the annual contract renewal period, thus preventing them from being able to analyze budgeted vs. actual program costs.

Division of Purchased Services: Regarding budgeting and budget monitoring, DPS has developed and implemented an Audit Resolution Policy that requires it to monitor certain variances, (e.g., service providers' total revenues over expenses) that exceed 5% on negotiated unit-rate contracts. Specifically, Section II (C) of DPS's Audit Resolution Policy states, in part:

In the event of a determination of any variance between reimbursement received under contracts funded by such prices and a provider's actual allowable expenses associated with such contracts, the information will be reported to DPS and the purchasing agency. This information is reported to DPS and the purchasing agency in the UFR supplemental schedules and the OMB A-133 Single Audit Schedule of Federal Financial Assistance. If any variance is greater than provided for in 808 CMR 1.19 (3) Non-Profit Maintenance Expense, [5%] DPS will advise the purchasing agency as to the circumstances or practices which may have caused the variance to occur, and how the information has been or should be considered in prospective contract negotiations to prevent such circumstances or practices from causing a reoccurrence of such variances. If the variance is less than that provided for in 808 CMR 1.19 (3) Non-Profit Maintenance Expense, no response will be required. . . .

Also, Section F, of DPS's Audit Resolution Policy, which requires state agencies to review any significant variances in staffing where there are indications that the level of staffing may not have been provided as agreed upon in the contract, if such a condition is indicated in an audit finding, states, in part:

For purposes of resolving audit findings concerning reimbursement, a determination that any program or cost category for which spending as it relates to staffing during the period was below 90 percent of the funds budgeted or allocated for staffing in any portion of the contracts funding such program or cost category, shall be referred to the purchasing agency for review of actual service delivery and quality levels.

Purchasing agencies are responsible for resolving the deficiency by determining if service delivery requirements, performance standards and/or minimum staffing or program standards have been met or need to be revised. Adequate resolution of deficiencies include the following:

- o No action is taken because staff vacancy was due to turnover and the position was subsequently filled.
- o Assist the provider through a corrective action plan that utilizes state resources to fill necessary vacant positions, when staff vacancies are the only deficiency and the provider has made a good faith effort to attain the necessary staffing during the year.
- o Establish corrective action plan to meet minimum service delivery requirements, performance standards, staffing, and program standards that have not been met and are needed.
- o Revise minimum staffing or program standards and reduce the rate of payment for staffing and program standards that are not needed.
- o Recover funds from provider when no effort was made to staff programs with employees possessing appropriate credentials, to fill vacant positions, or to amend contracts for positions that are not needed.

Although DPS's Audit Resolution Policy addresses the need to review some variances (e.g., excessive surpluses) on an exception basis and staffing deficiencies at service providers, the policy relies on these conditions to be identified by a third party (e.g., the Office of the State Auditor) and there is no requirement that state purchasing agencies or DPS routinely perform these critical analyses. In addition, as noted in Systemic Problems at the State Agency Level No. 1, neither DPS nor state agencies are effectively utilizing the data being provided to them by service providers (e.g., UFRs) to independently make this determination. Moreover, according to one official at DPS with whom we spoke, private auditing firms who audit service providers do not routinely perform this analysis nor does the UFR contain the information necessary to perform this analysis. Also, this policy does not address other areas that should be of concern to state purchasing agencies, which as significant variances between budgeted line items other than staffing that may be the result of programmatic or fiscal mismanagement. Finally, DPS's Audit Resolution Policy deals with surplus and understaffing, but does not address other crucial situations such as when state agencies may be underfunding programs, and thus potentially causing providers to furnish substandard services in these programs.

Recommendation: Currently the administration is using or investigating the use of other contracting methods, such as output-based purchasing through which the purchaser (state agency) would specify desired results while the bidder for these services would prepare options as to how most effectively and efficiently to achieve these results; performance based contracting, where a service provider is compensated based on its ability to deliver certain measurable outcomes; and providing clients with vouchers so that they may procure from the most appropriate provider their desired services. These types of contracting methods, which typically utilize nontraditional budgeting and other program monitoring techniques, may eventually prove to be more efficient and effective than existing methods. However, any new contracting methods that the administration proposes to use should be fully analyzed (e.g., costs vs. benefits as compared to existing contracting methods) by an independent task force prior to being adopted.

Also, any contracting method developed should be implemented systemwide, and the administration should require state purchasing agencies to develop comprehensive contracting systems. For example, if the state decides to utilize, where possible, more performance-based contracting, it should require state purchasing agencies to establish reasonable performance measures, standards for service delivery, oversight procedures to identify the causes of any poor performance, sanctions for poor performance, and management information systems to collect and analyze relevant data. Any outcome measures developed should be reasonable but not be so easily obtainable as to reward service providers for mediocre performance. Regardless of what type of contract pricing method the state chooses to implement, it is important that program budgets are realistic and properly utilized as a means of planning, evaluating, and coordinating program services. Adherence to realistic program budgets is essential to the success of any economic enterprise, profit or not-for-profit. Given the strong interdependent relationship between the state

and its contracted service providers, it is particularly important to equitably fund program services to ensure the financial stability of service providers, the continuation of the provision of program services, and, where possible, the improvement of these services to the benefit of the consumers being served.

However, until the state develops and implements new systemwide contracting methods, the existing approach for developing program budgets and unit rates of compensation for negotiated unit-rate contracts should be made more effective, as follows:

1. Based on the information it obtains through its UFRs, DPS should develop a POS data base and corresponding management information system that collects and analyzes service providers' costs as detailed on their UFRs by service type and geographic location and produces statistical summaries of this information for each fiscal year. DPS should make this information available to state agencies prior to their beginning their annual contract negotiation process. Such information would prove more valuable in the contract negotiation and renewal process, since it would allow state purchasing agencies to have program component costs by service type and geographic region statewide. DPS should also use this information to conduct regular financial analyses of this information to ascertain the financial condition of service providers and the POS system as a whole and take the measures it deems necessary to address any problems noted.
2. DPS should amend its current regulations to include formal budgeting/budget monitoring procedures that state agencies should follow. At a minimum, these regulations should require state agencies to negotiate initial contracts and contract renewals with service providers using, where applicable, the provider's actual historical costs for the program, DPS's Component Price Catalogue, and information from DPS's POS data base as recommended above, as a basis for these negotiations. We recognize that using only a program's historical costs to establish program budgets (cost-based budgeting) is difficult due to the fact that the UFR cost information an agency has may often be up to 18 months old. However, notwithstanding any significant changes in the operational aspects of the program, historical costs in conjunction with the CPC, and any other industry knowledge state agencies may have, will better enable them to negotiate equitable contracts. DPS should also require state agencies to annually review actual to budgeted program costs prior to renewing these contracts and obtain explanations from the provider as to any significant variances that may occur between these two costs. Other controls DPS may want to consider implementing include requiring state agencies to obtain approval from DPS for any negotiated program component that significantly exceeds (e.g., greater than 10%), the providers historical cost for the component. This will allow some flexibility in remedying any past problems of underfunding the program the provider may have experienced and would also place some control over increases in program costs.
3. DPS should continue to develop training programs relative to contract negotiations and contract renewals that would address what information, regulations, industry guides, and other reports should be reviewed by the purchasing state agency prior to the negotiation process.
4. The administration should determine what resources would be necessary to implement the recommendations identified above and ensure that state agencies have these resources available to implement these or other changes DPS in its budgeting and budget monitoring process.

3. State Agencies Have Not Developed and Implemented Formal Processes for Determining Their Clients' Service Needs and in Some Instances Are Not Complying with State Laws and Regulations Relative to Involving Area Boards in Establishing These Service Needs. As a Result, the Commonwealth Cannot Be Assured That the Most Effective Types and Levels of Program Services Are Being Procured or Whether These Services Are Being Provided in an Equitable Manner

The Determination of Needs (DON) process is the first and one of the most important aspects of an agency's service delivery system. An effective DON process serves to ensure that agencies procure the type and amount of services that will best serve their target client population in the most effective and efficient manner. An effective DON process not only provides a means of identifying the particular demand for a service type, but also helps determine what program services are more effective in treating the problems that exist with a particular agency's client population. An effective DON process also allows an entity to allocate its limited resources on a prioritized basis in concert with this determination.

Currently, DPS regulations do not require state agencies to develop and implement a formal DON process. In fact, in its User Handbook, DPS only makes reference to the DON process by stating:

At the beginning of the overall cycle is the state agency's planning and prioritization of service needs for its clients. Service delivery decisions are made on the basis of need, as determined by a variety of criteria, and anticipated funding. . . .

During our audit of the five state agencies that we reviewed, we found that the DON process being utilized by these agencies varied significantly. For example, DMH was in the process of developing and implementing a formal DON process, while DSS had no formal process and was in fact in violation of some of its regulatory requirements relative to DON. The results of what we found at the five state agencies are as follows:

Department of Youth Services: According to DYS officials, DYS's DON process is performed at its central office and is based upon statistical reports indicating the type and number of youths being served over a five-year period, the amount of funding for the fiscal year, and input from the regional directors who have monthly meetings at DYS' central office and discuss the service needs in their region. However, DYS has not developed and implemented a formal DON process and does not maintain documentation to support how it assesses and makes service delivery decisions. During a site visit to DYS's Boston regional office, the Regional Director indicated that there had been a formal needs assessments process prior to 1990, but that budget cuts which reduced staffing, had put an end to that process.

In addition, MGL Chapter 18A, Section 9, establishes within DYS an Advisory Committee, which is to consist of the commissioners of DYS, the Department of Public Welfare, DMH, the Department of Education, DOC, Probation, and Rehabilitation; the Chairmen of the Parole Board and the Massachusetts Commission Against Discrimination; and the Executive Secretaries of the

Massachusetts Society for the Prevention of Cruelty to Children and the Massachusetts Committee on Children and Youth; and the Director of the Office for Children. There are also nine other persons appointed by the Secretary of EOHHS, with the approval of the governor. Among its duties, the Advisory Committee is required to:

Advise the commissioner on policy, program development and priorities of need in developing a comprehensive program (1) for the treatment, rehabilitation and custody of juvenile offenders, and (2) for integration of the juvenile offender into constructive community life.

Although this committee is supposed to advise DYS as to service needs within its client population, DYS officials could not provide us with any documentation to substantiate that the Advisory Committee has input in determining DYS's service needs. In fact, DYS's Director of Administrative Services and its Director of Contracts told us that they had no knowledge of any advisory committee input relative to DYS's service needs.

As noted in Systemic Problems at the State Agency Level No. 1, in September of 1993, the Secretary of EOHHS convened a committee to conduct an assessment of DYS, identify service gaps, and make recommendations. In its January 18, 1994 report, this committee indicated that DYS had "lost touch with its population." High-risk youths were prematurely placed in the community and court-committed youths were being sent home without assessment or evaluation. The report indicated that public and judicial confidence had been undermined and that DYS staff had become demoralized. The report recommended that DYS implement a comprehensive classification system to measure a youth's risk to public safety and individual service needs.

Department of Social Services: The Massachusetts General Laws, Chapter 18B, Section 7(d) requires DSS's Commissioner to "conduct an annual needs assessment for all social services under the control of the department." Our review indicated, however, that no such annual needs assessments were performed by the agency. Specifically, based upon information we received from DSS's central and area offices, the department has not developed and implemented a formal DON process. Additionally, Section 13 of Chapter 18B further requires DSS to establish social service area boards in each of its geographic service areas. These area boards are to consist of 21 members and are to be appointed by the Commissioner of DSS for three-year terms. Some of the powers and duties of these area boards, as detailed in Section 15 of Chapter 18B, are as follows:

1. to act as the representative of the citizens of the area;
2. to advise regarding local needs and resources in the development of comprehensive social services;
3. to review and approve the annual area plan and to make recommendations concerning the annual budget for the comprehensive social services of the area;
4. to review arrangements and contracts for programs and services which are a part of the program of the area;

5. to consult with the commissioner in personnel recruitment and appointment policies, in the establishment of program priorities for the area, and in policies regarding relationships with other agencies and organizations;
6. to discuss any matters concerning the area program; and
7. to hold at least four regular meetings in each year and to convene special meetings on the call of the president, or ten members of the board, or the area director. The area director shall be notified of, and may participate in, all meetings, but shall not vote;

In addition, DSS regulations 110 CMR 15.10 (1) and (2) state, in part:

1. Each area board shall participate in the needs assessment for social services in the area. The needs assessment shall be conducted annually.
2. The purpose of the needs assessment process is to identify social services needs by area residents, which are either not being offered by the department, or are not offered in sufficient quantity or quality. The needs assessment shall be conducted and reduced to writing following uniform guidelines developed by the department.

Clearly, the intent of these sections of Chapter 18B and 110 CMR is to ensure that social service consumers have substantial input as to the amounts and types of services provided in their geographic area.

However, based on our review we determined that DSS does not perform an annual area board needs determination as required by Chapter 18B and has not developed the uniform needs assessment guidelines required by 110 CMR 15.10. Specifically, we randomly selected 10 of DSS's 26 area offices to review and determine to what extent they were complying with the requirements of MGL Chapter 18B and 110 CMR. Based on our review of the information provided to us by these area offices, we determined the following:

- o One of 10 areas had no area board.
- o None of the remaining nine boards had the full board membership (21 members) required by statute. Rather, memberships ranged from six to 15 members.
- o There was no documentation to substantiate that any of the nine existing boards participated in any annual needs assessments in their respective areas. Rather, the information we obtained from these nine area offices indicated that area board members primarily were involved in fundraising activities and in some instances, assisted in the review of program proposals and the selection of service providers.
- o There was no documentation to substantiate that any of the nine existing boards reviewed and/or approved area office service plans or area office budgets.
- o There was no documentation to substantiate that any of the nine existing boards participated in the selection of the area office director as required by statute.

As previously noted, Andersen Consulting, at the request of the Governor, performed an organizational assessment of DSS. Some of the findings relative to DSS's needs assessment and

DON processes included the following:

- o The development and imposition of management initiatives which are not driven by the reality of the cases and the needs of the children and do not address critical problems.
- o There is an unsatisfactory process for ensuring that the mix of services provided meets the needs of the consumers of those services.

Regarding area boards, DSS officials told us that because the area offices' "program specialists" and the Central Office's "Director of Citizen Board Development" were eliminated in 1989 and 1991, respectively, there has been little, if any, direction as to how the boards should operate in relation to the area offices.

Department of Correction: Our review indicated that DOC has not developed and implemented a formal DON process. Specifically, DOC has no written procedures for assessing the need for its purchased services and does not maintain documentation to support how it assesses and makes service delivery decisions.

According to DOC officials, program needs are informally determined based upon a number of criteria, including funding, inmate population/statistical data, legislative mandates, program capacity, and social and philosophical changes. Although DOC serves a somewhat fixed population, programs should be initiated based on a formal, documented needs assessment. Without such a formal process, DOC may establish programs that are underutilized or less effective than other programs that may have been implemented to address a specific service needs of DOC's client population.

For example, our review of DOC's substance abuse program, initiated in fiscal year 1993 at its Bridgewater boot camp, disclosed that there was no written documentation indicating how the need for this program was determined prior to the service's being purchased. We further determined that the occupancy rate for this program during the fiscal year was only 29% of capacity. This low utilization rate raises questions relative to the need for this program.

Moreover, the overall occupancy rate problem at the boot camp facility was also detailed in a May 1993 report issued by the House of Representatives Post Audit and Oversight Committee. In its report, the committee accused the Administration of failing to determine whether there were enough inmates in the state's prison system who could qualify for the boot camp before it was built.

Department of Mental Retardation: Our review of the DON process utilized by DMR revealed the following problems:

- o DMR's central office has not developed a formal DON process to be utilized by its regional and area offices.
- o The DON process varies by region; each region is responsible for developing its own procedures.

- o Only one out of the five DMR regional offices had attempted to develop and implement a formal DON process that documents the prioritization of its service needs.
- o There was inadequate documentation to determine the level of input from various sources such as advisory boards.

At DMR, the DON process is performed at each of the five regional offices with input from the 27 area offices. According to DMR officials, although the process varies in each region, the criteria used in the process are the same for each region and include:

- a. Funding - appropriations from the legislature to DMR are allocated to each region based upon spending plans that are evaluated at the central office.
- b. Current Service Level - regional funding must provide for the maintenance of clients already being served.
- c. Institution Operations - must provide for serving clients in DMR facilities.
- d. Waiting Lists - each region maintains a prioritized listing of individuals waiting to be served depending upon funding availability.

Our review indicated that allocation of funds to each region follows a standard procedure of submitting spending plans to the central office. However, we found that DMR's central office has not developed or implemented a standard DON process and that the process followed by each region in determining needs varies. In four of the five regions, the process followed in determining needs and prioritizing waiting lists was not documented. Regional office officials in each of these four regions indicated that service needs are determined and prioritized at the area office level based upon individual service plans (ISPs) with input from service coordinators, guardians, family members, and area and regional advisory boards. Although we noted that ISPs, notes from meetings, and waiting lists for program services existed, regional office staff could not provide us with any documentation to substantiate how service needs were formally determined and budgeted for, based on this information.

In contrast, we found that DMR's Region III (Community Services Center North) had established a Placement Committee within the region and had developed a more formal process for assessing clients needs, which involved developing numeric scores for individuals, and placed them in a prioritized manner on waiting lists for program services. The score is computed through the use of a priority assessment tool that assigns points based upon standard criteria that include client characteristics, home situation, and caretaker status. Although this client assessment and placement process does not constitute a comprehensive DON process, it does provide the region with a documented process and consistent direction over service delivery for all area operations within the region.

Our review of DMR's needs assessment process also involved an examination of the level of involvement of advisory boards in this process. DMR is authorized by MGL, Chapter 19B, Section 12, to ensure citizen, consumer, and family participation through the appointment of

citizens' advisory committees at the various organizational levels. Under 115 CMR 5.00, the citizen advisory boards' powers and duties have been codified and expanded to include board appointment, membership requirements, terms of office, and powers and duties of the various boards.

The powers and duties of the local service center advisory boards include:

- o to act as the representative of the citizens of the local service center;
- o to advise regarding local needs and resources in the development of comprehensive mental retardation services;
- o to advise in the recruitment and selection of the local service center director;
- o to advise through monitoring functions for programs;
- o to assist in the siting of community programs;
- o to consult with the Commissioner concerning program priorities, policies, personnel, etc.;
- o to consult with the statewide mental retardation advisory council;
- o to suggest to the Commissioner members for appointment to regional citizen advisory board; and
- o to hold regular meetings in each year.

The powers and duties of the regional citizens advisory board include:

- o to advise the regional directors on program development and priorities of need;
- o to advise in the recruitment and selection of the regional director;
- o to review and make recommendations concerning the annual budget for mental retardation services of the region;
- o to hold at least three meetings in each year; and
- o to elect officers of the board.

However, based upon our review, we found that although each of the five regional offices within DMR indicated that they received advisory board input into the needs assessment process, they were unable to provide us with any documentation to substantiate either the level of input or the impact of the advisory boards in DMR's DON process. Regional Directors emphasized the importance of these boards; however, there are no department requirements for documenting or assessing board input. We also found that in Region VI (Metro Boston) there is only a regional board and no area boards because of the region's small geographic area. The regional director indicated that the consolidation of area and regional boards was at the request of board members and that this board does meet monthly and has input concerning service needs. However, this board's input on services could not be determined during our review.

Department of Mental Health: As of the end of our audit field work, DMH had not yet implemented a formal and uniform DON process. However, in contrast to the other four agencies we audited, DMH is currently in the process of reorganizing its service delivery system through a shift from state hospital inpatient care to an expanded community-based service system for adults, children, and adolescents. As part of this reorganization, DMH contracted with a private contractor, Human Services Research Institute (HSRI), in 1992 to conduct an assessment of the service needs of current consumers of DMH's services. In order to perform this assessment, HSRI divided the state into 33 mental health service delivery areas. As of the end of our audit field work, 28 areas had been evaluated for clients' needs, while the remaining five areas located in Metro Boston were in the process of being evaluated.

According to DMH officials, this survey was conducted on the basis of sociodemographic characteristics, clinical characteristics, service needs, and delivered services. Data for this study was collected from interviewing both consumers and providers. Currently, DMH is using the results of this needs assessment in its planning and management activities. The agency has identified what programs are available and the level of utilization that is needed for its client population. According to DMH officials, this process will be developed into a formalized DON system that DMH can continue to follow.

Our review in the area of client needs assessment also included an examination of the level of involvement of area boards. DMH is authorized by the MGL, Chapter 19, Section 15, to provide for and to cooperate with citizen advisory boards at its facilities and at each geographic area of the department. The powers and duties of these area boards include the following:

- o To act as the representative of the citizens of the area;
- o To advise regarding local needs and resources in the development of comprehensive mental health services;
- o To advise in the recruitment and selection of the area director;
- o To review and make recommendations concerning the annual budget for the mental health services of the area;
- o To consult with the Commissioner in the establishment of program priorities for the area;
- o To communicate with the mental health advisory council, established under Section 11, to discuss any matters concerning the area program; and
- o To hold regular meetings in each year.

Under 104, CMR 2.16, these powers and duties have been codified and expanded to include area board appointment and membership requirements, as well.

However, we determined that the level of citizen advisory board involvement with DMH's seven area offices varied by geographic area and that there was inadequate documentation to assess advisory boards overall impact in the development of the DMH's mental health services. Our review of the information provided to us by area office personnel disclosed that only three citizen advisory boards were operational during our audit period. Moreover, although these "active" boards conducted regular meetings, they did not uniformly perform the legislative duties previously outlined and did not participate in the area office operations detailed in these regulations.

Although DMH has taken measures to develop and implement a formal DON process, such a process has not yet been fully implemented, and the other four agencies we audited had not yet attempted to implement such a formal process. Therefore, these state agencies cannot be assured that they are procuring the most effective types and amounts of program services or that clients in each of these agencies service areas are receiving program services on an equitable basis.

We acknowledge that, for the most part, the state agencies we audited had mechanisms to measure the demand for their existing program services, (e.g., waiting lists) and mechanisms to provide input as to their clients' specific service needs (e.g., case managers). However, none of the agencies we audited had developed and implemented a formal documented DON process through which client information is collected and analyzed by management, in a standardized manner and on a continuous basis, in order to effectively assess the current and future service needs of their client population and is used to procure program services on a prioritized basis in accordance with their stated mission. The failure to document the DON process makes it impossible to independently assess whether the process is fair and equitable or whether there is input from all sources, including the various advisory boards, many of which have statutory responsibilities to participate in determining client needs and program requirements. The need for a formalized documented agency DON process is an essential internal control mechanism, especially to purchasing agencies that have decentralized organizations with regional and/or area offices ultimately funding programs.

Recommendation: Since many of the social services procured by state agencies are unique, it would not be practical for DPS, as the oversight agency, to develop a single DON process to be utilized by all state purchasing agencies. However, DPS should require state agencies to develop and implement a formal DON process, similar to that being developed by DMH, and to document this process. This formalized process, at a minimum, should be in writing, reviewed and/or approved annually by the head of each agency, and changed/modified as necessary to meet the changing demographics and specific service needs of each agency's client population. Any process developed by state agencies should, to the extent possible, be consumer-driven within the limits of budgetary constraints and, as such, should ensure that input is received from those communities in which the services are being delivered and that program services are delivered on a fair and equitable basis in the most efficient and effective manner (e.g., based on a prioritized list). Where applicable, state agencies should ensure that they comply with their regulations relative to the involvement of area boards or committees in their DON process and should document the activities of these boards/committees relative to this process.

4. State Agencies Are Not Maintaining Accurate Inventories of the Furnishings and Equipment Service Providers Are Purchasing with State Funds. As a Result, There Is No Assurance That the Millions of Dollars in State-Owned Property Provided to Human Service Providers Is Being Properly Safeguarded against Loss, Theft, or Misuse or Whether the Amount of Depreciation Being Claimed on Service Providers' Financial Statements Is Accurate:

State regulations require state agencies to maintain accurate inventories of their fixed assets (e.g., furnishings and equipment) that they use and/or that they provide to their contracted service providers to operate state-funded programs. However, we found that five state agencies, had not developed or implemented effective, efficient, and reliable inventory systems. As a result, the state cannot be assured that the millions of dollars in state-owned fixed assets at these service providers are being properly safeguarded against loss, theft, or misuse or that the state's inventory of fixed assets is being accurately reported on its financial statements.

Under DPS's General Contract Conditions, service providers are required to maintain inventory systems that clearly identify which of a provider's fixed assets were purchased with state funds, as well as the source of these funds. In part, this requirement serves to ensure that service providers do not depreciate fixed assets that the state purchased and holds title to. However, 14 of the 40 (35%) providers we audited were not maintaining inventories in accordance with the requirements of DPS's General Contract Conditions. These 14 providers had inventories valued in excess of \$4.1 million during the period of our review. Because these providers were not maintaining their inventories in accordance with DPS General Contract Conditions, it could not be determined how much of this \$4.1 million in furnishings and equipment was state-owned and, therefore, whether the depreciation that these providers were taking on these assets was appropriate.

MGL Chapter 7, Section 4A, stipulates that the Department of Procurement and General Services (DPGS) will ensure a periodic inventory of state-owned tangible personal property for the purpose of the accountability of fixed assets and also providing auditable asset information in keeping with generally accepted accounting principals (GAAP). According to state regulations (802 CMR 6.00) promulgated by DPGS, all state departments and agencies, including the judiciary and all state educational institutions, are required to maintain an inventory of their fixed assets and are required to annually submit to DPGS an Annual Asset Management Report Form, which indicates the value of these assets. These report forms are intended to provide a mechanism that allows the Commonwealth to generate accurate financial reports/statements and to ensure that its fixed assets are being properly safeguarded against loss, theft, or misuse. According to 802 CMR 6.04(3), the process of recording and reporting fixed assets by state agencies is as follows:

All assets will be recorded in the Fixed Assets Sub-system of MMARS [Massachusetts Management Accounting and Reporting System] or in an asset management system housed and maintained at the department level as specified below:

- (a) All GAAP and Major Fixed Assets will be recorded in the Fixed Asset Sub-system of MMARS.

GAAP Fixed Assets refer to buildings, equipment and construction in progress (including all furnishings and fixtures) with a historical cost of \$15,000 or more and all land.

Major Fixed Assets refer to buildings and equipment with a historical unit cost of between \$5,000 and \$14,999.99.

- (b) All Minor Fixed Assets will be recorded in an asset management system housed and maintained at the department. Minor Fixed Assets are buildings and equipment with a historical cost between \$100 and \$4,999.99.

Minor Fixed Assets refer to equipment which:

1. Can be identified as a unique item
2. Has historical unit cost between \$100 and \$4,999.99
3. Has a useful life of more than one year
4. Is moveable, not fastened permanently to walls, ceilings or floors.
5. Canned software packages acquired for departmental use (e.g., spreadsheet, database, and word processing packages).

When purchasing program services, state agencies often provide contracted service providers with a capital budget that allows them to purchase the fixed assets they need to operate the program and provide the necessary program services. Regarding Fixed Assets, DPS's General Contract Conditions, Section IV(D) states:

Title to furnishings and equipment of a value of \$500 or more, with a useful life of more than a year, and purchased pursuant to the capital budget of a Service Contract shall vest in and be retained by the Purchasing Agency.

Also, Section VIII(A)(2), of DPS's General Contract Conditions require contracted service providers to maintain a separate inventory of all state-owned property, as follows:

Any Provider which is in possession of furnishings or equipment to which the Purchasing Agency has title shall label, maintain, and keep on file a written inventory of all such property. Said inventory shall contain the source of funding, the description and location of each item as well as such other information as may be required by the Purchasing Agency. Upon completion of performance hereunder, the Provider shall retain furnishings and equipment subject to Section IV(f) for its use in performance of health, social or rehabilitative services and shall continue to maintain a written inventory unless and until, following reasonable advance notice, the Purchasing Agency removes such furnishings and equipment. Removal shall be at the Purchasing Agency's expense. . . .

Further, DPS regulation 1.15(2)(d) does not allow a provider to depreciate state-owned property by identifying the following as a nonreimbursable cost:

Depreciation on assets acquired under a capital budget approved by a public agency entirely with public funds and held in trust for the Commonwealth of Massachusetts under the terms of a service contract.

At the five state agencies that we reviewed, we found the following problems with the information being maintained by these agencies relative to state-owned property located at human service providers.

Department of Youth Services: Our review indicated that, although DYS has taken steps to implement a fixed asset management and reporting system for state-owned property being used by contracted service providers, this system is inaccurate and ineffective. Specifically, the majority of each service provider's furniture and equipment that is purchased with state funds is ordered by DYS's central office, which maintains a record of these purchases and provides this equipment to its service providers. DYS then relinquishes control and relies on the provider to report all inventory changes (e.g., disposals or loss) to the central office. However, DYS does not test the accuracy of these reported changes, nor does it conduct physical inventories of state owned equipment held by providers. Consequently, during our review we tested the accuracy of the inventory information maintained by DYS relative to state-owned property that it provides to its contracted service providers. This information indicated that, as of the end of fiscal year 1993, there were furnishings and equipment items valued at \$1,217,219 at 21 programs operated by service providers. However, when we randomly selected inventory items from this listing and compared the cost of these items to their actual costs, we found many discrepancies. For example, one file cabinet that had a purchase price of \$150 was valued at \$15,000 on DYS's inventory listing, and a drill costing \$250 was valued as \$25,000 on this listing.

Department of Social Services: DSS does not have any policies or procedures relative to maintaining an accurate and complete inventory of furnishing and equipment items its contracted service providers purchase with state funds. Specifically, DSS's central office does not require its service providers to submit annual inventory records to it, and DSS area offices did not conduct periodic inventories of the furnishing and equipment items purchased by contracted service providers with state funds in their service area. Also, DSS officials could not tell us the amount of funds they gave their service providers in capital budgets for furnishings and equipment items, because the department does not compile or monitor this data.

Department of Correction: DOC has not developed and implemented any formal internal controls (i.e., policies and procedures) over the furnishings and equipment items that its contracted service providers had purchased with DOC funds. Specifically, DOC does not require its contracted service providers to submit annual inventories of their furnishings and equipment items, DOC staff do not conduct periodic inventories at providers, and DOC does not maintain an updated inventory listing of all state-owned furnishing and equipment items purchased by its service providers.

Department of Mental Retardation: Our review disclosed that, although DMR's central office Core Services Unit is responsible for maintaining a record of all provider physical property inventories, these inventory records were inaccurate. In addition to DPS's inventory requirements noted above, in 1982 DMH developed a Physical Property Control Instruction Manual that is currently utilized by DMR. This manual requires DMR's area offices to update physical property records when any of the following occurs: (1) new property is received; (2) property is lost or stolen; (3) property is transferred from one location to another; and, (4) property is beyond repair or surplus property is disposed of.

In order to update these records, DMR officials told us that its central office Core Services Unit annually sends a copy of the provider inventory that is in the unit's data base to each DMR regional office. The regional offices forward these inventory listings to the individual service providers for verification. The service providers are then asked to return these verified and updated listings to their respective regional offices. DMR's regional staff then sign off as to having reviewed this information, which is then sent back to the DMR's central office and entered into DMR's provider inventory data base.

In order to assess the accuracy of DMR's provider inventory database, we first obtained a listing from DMR officials of the 57 providers who where provided capital budgets for program services during fiscal year 1993. This listing totaled \$1,050,068 for these 57 providers. We then took a sample of this list consisting of 13 providers who received capital budgets in their contracts totaling \$366,318 during this fiscal year. Based on our testing, we confirmed that these 13 providers expended \$356,501 that they received through capital program budgets from DMR. However, DMR's provider inventory database did not show any capital purchases made by these providers as of September 17, 1993, although DMR's database had purportedly been updated with fiscal year 1993 data from DMR's service providers in May 1993. Consequently, although DMR's central office has a process that requires each regional office to have its contracted service providers prepare, update and submit lists of fixed assets to the regional office, DMR does not conduct periodic physical inventories of these items at its service providers and does not correlate the information from the capital budgets it provides to its service providers to its inventory listings to verify the accuracy of this information. As a result, as detailed above, DMR's inventory records for fiscal 1993 were incomplete and unreliable.

Department of Mental Health: Based on our review, we determined that DMH's internal controls relative to furnishings and equipment items purchased by its contracted service providers were inadequate. Specifically, DMH has not established any written policies and procedures relative to the inventorying of these items and does not require its contracted service providers to submit an annual inventory listing of all the assets in their possession to which the state holds title. Also, with the exception of one area office (Western Mass. area), none of DMH's area offices maintain a listing of the furnishings and equipment that their contracted service providers purchased with state funds nor do they conduct periodic physical inventories of these items. Regarding this matter, DMH officials indicated, that their internal controls over inventory were inadequate, and that they would take measures to improve their inventory procedures in this area.

In addition to the deficiencies we found at the state agencies, we also found that 14 of the 40 (35%) providers we audited were not maintaining inventories in accordance with DPS's General Contract Conditions. The 14 providers had inventory values totaling approximately \$4.1 million.

However, because these providers were not maintaining their inventories in accordance with DPS General Contract Conditions it could not be demonstrated how much of this \$4.1 million in furnishings and equipment was state-owned. Also, it could not be determined whether the depreciation that these providers were taking on these assets was appropriate since, as previously noted, providers are not allowed to depreciate assets that were purchased with state funds through a capital budget.

Because the state agencies we audited have not established adequate systems of internal controls over the furnishings and equipment purchased by contracted service providers to which the state has title, the Commonwealth cannot be assured that all of its assets are being properly safeguarded against loss, theft, or misuse. This is of particular concern, given that the items being purchased by these service providers with these funds include such high-theft items as furniture, appliances, televisions and audio-visual equipment, computer equipment, and vocational and educational equipment. Additionally, their reporting of the value of their fixed assets to the State Comptroller, which is required by state regulations, and the amounts presented in the state's financial statements may also be inaccurate. Finally, there is inadequate assurance that the depreciation expenses service providers are declaring on their UFR's are accurate.

Recommendation: As a result of our audit work, DPS proposed regulations, effective July 1, 1994 (fiscal year 1995); to require state agencies to:

Maintain a written inventory of the property in such form as directed by the Division. Upon termination of the provider's agreements with the Purchasing Agency, the equipment shall be returned to the Purchasing Agency or, in accordance with instructions of the Purchasing Agency, transferred to another provider doing business with the Commonwealth.

This regulatory change was appropriate and necessary. However, in order to effect better control over the furnishings and equipment contracted service providers purchase with state funds, we recommend that the following additional measures:

1. Where applicable, state agencies should take the measures necessary to fully comply with the requirements of state regulations and implement effective asset management systems. In addition to those state-owned assets in the possession of the state agencies, these systems should include the proper accounting for those assets purchased by service providers with state funds (i.e., with monies they received through program and/or capital budgets.)

In order to ensure the accuracy of the information within their asset management systems, state agencies should detail how assets, in particular multiple purchases of the same items, should be valued by the purchasing entities, (i.e., regional and/or area offices). Also, state agencies should require their contracted service providers to conduct annual inventories of their state-owned items and submit a complete listing of these items to the agency. These listings should indicate a description of the item; its location; historical cost (including shipping and installation); date of acquisition; state agency funds that were used to purchase the asset; and, where applicable, date of disposition and the reason for disposition (e.g., obsolescence, theft). Principal state purchasing agencies should disseminate this information to DPS and the applicable state contracting agencies.

2. DPS should establish and require service providers to follow uniform inventory procedures. In addition to what is already required by DPS regulations and General Contract Conditions, those policies and procedures, at a minimum, should address how service providers should account for inventory acquisitions (e.g., through purchase or donation) inventory control, and the disposition of these assets (e.g., as a result of damage, loss, or obsolescence).

Such information submitted by service providers would allow DPS to assess the reasonableness and allowability of the depreciation expenses being charged by service providers against state contracts. Finally, such policies and procedures would serve to enhance the system of internal controls providers' develop and implement over their operations (see Regulatory Deficiencies No. 7).

REGULATORY DEFICIENCIES

During of our audit we found several instances in which the regulations DPS had promulgated relative to the administration of the POS system could be improved. Our specific concerns relative to DPS's regulations, examples of problems we found as a result of these regulatory deficiencies,¹³ and our specific recommendations on addressing these problems follow:

1. Inadequacies in DPS Regulations Relative to Related-Party Transactions Resulting in Millions of Dollars in Unallowable Expenses: During our review we found many instances in which providers doing business with the state were also doing business with "related parties." The 808 CMR 1.02, promulgated by DPS, defines a "related party" in part, as follows:¹⁴

Any of the following are considered a related party to the provider subject to disclosure and certain reimbursement restrictions when providing rent, services, loans, payments, conveyances, gifts, any other transactions or having receivables or payables associated with a transaction to or from the provider.

- (a) A person who is or was within the preceding five years a director, stockholder, partner, administrator, manager or trustee of the reporting provider, or a relative of such a person, or an organization in which a person, who currently serves as a director, stockholder, partner administrator, manager or trustee of the organization, or a relative of such a person is, or was within the preceding five years, a director, stockholder, partner, administrator, manager or trustee of the reporting provider....
- (b) Any organization, corporation, partnership, or fiduciary trust where any common ownership or control is held by a person who falls within the scope of paragraph (a) above or by a relative of such a person....
- (c) Another corporation, partnership, organization or individual doing business solely with the reporting provider or the provider's related parties; or,

¹³ The audit results presented in this section of the report are abbreviated. A complete discussion of these results are presented in the individual reports that were issued by the OSA which are identified in Appendix A.

¹⁴ This is the definition of a related party as it appears, in part, in DPS regulations 808 CMR 1.02, effective October 20, 1992.

- (d) A person or organization associated or affiliated with the reporting provider. A person or organization is associated when the person or organization engages in a joint program or business venture directly or indirectly in which the provider or other person or organization receives direct or indirect financial benefit. A person or organization is affiliated when the person or organization:
1. controls a provider; or
 2. is controlled by a provider or
 3. is under common control with the provider....

Transactions between "related parties" are a common occurrence in a business environment. However, unless otherwise noted, all transactions reported in an entity's financial statements are presumed to have been conducted in an arm's-length manner. That is to say, no party to the transaction could use its influence to make the transaction different than what would have occurred in an open, free, competitive market environment. Consequently, for those transactions that are not conducted at arm's length, generally accepted accounting principals (GAAP) and state regulations (808 CMR 1.00) require entities to disclose such transactions and conditions so that users of this financial information can reach more informed conclusions about an entity's financial activities. Additionally, state regulations limit the amount of money that can be paid by a contracted service provider to a related party for goods and/or services using state funds. Specifically, 808 CMR 1.15(8) states, in part:

Costs to the related party shall be allowed only to the extent that they would be allowable if incurred by the provider. For example the price published in the Component Price Catalogue or established by the Rate Setting Commission would be allowable. However, where a provider has failed to disclose a related party transaction, only the lower of actual costs, costs established in the Component Price Catalogue or market value will be allowable.

During our review, we found, at five (13%) of the 40 providers we audited, significant problems relative to related-party transactions, including some providers' failure to disclose their related party relationships and/or providing compensation to related parties for goods/services in excess of what was allowed by state regulations. The total excessive compensation we found at these five providers exceeded \$2.3 million. We also found instances in which service providers were using state funds to secure loans for or provide loans to their related parties (e.g., family members), as well as other questionable related-party transactions. In some instances these transactions could have adversely effected the financial stability of the provider, thereby jeopardizing the welfare of the clients these providers were serving. Examples of the problems we found at the human service providers we audited follow:

The Founders of Southeastern Regional Vendor Educational and Support Services, Inc., (SERVESS) and Day and Residential Service Options, Inc., (DARSO) Defrauded the Commonwealth of \$1 Million over a Five-Year Period through a Scheme that Exploited the State's Purchase-of-Service System: The founders of SERVESS and DARSO conspired to conceal non-arm's-length, related-party transactions by using intermediary companies or realty trusts that they owned and controlled to artificially inflate the costs reimbursed by the Commonwealth. Their scheme involved SERVESS; DARSO; Community Services, Inc.,(CSI); Trescott Corporation Trust (Trescott), the company organized to manage the trusts' leases; Underwood Company; TALL Enterprises, the five realty trusts and other entities owned or controlled by the founders; and a trustee of the realty trusts. The two founders were able to illegally pass on approximately \$1 million in inflated costs to the Commonwealth over a five-year period. Contracting forms filed by SERVESS and DARSO with the State Comptroller did not indicate any non-arm's-length, related-party transactions, and SERVESS and DARSO, at the direction or under the control of their founders, denied any transactions with related entities, thereby hiding the partnerships. However, subsequent to our audit, the two founders of SERVESS and DARSO pleaded guilty to 14 counts of mail fraud, and the trustee of the realty trusts pleaded guilty to one count of racketeering.

Tri County Youth Programs, Inc. (TCYP) Paid \$23,278 in Unallowable Costs to a Related Party: In February 1984 three members of TCYP's Board of Directors formed Agaric Associates, Inc., (Agaric) in accordance with MGL, Chapter 180, and conducted related-party transactions with this entity. However, we noted instances in which TCYP violated DPS regulations governing related-party transactions. Specifically, we found that, during fiscal year 1990, TCYP leased three residential properties from Agaric to operate its Springfield and Northhampton Hill Adolescent Centers and Gill Transitional Home programs. TCYP paid Agaric \$23,278 more than the costs incurred by Agaric to own and maintain these properties and, in so doing, overcharged the state by this amount.

Franklin/Hampshire Community Mental Health Center, Inc. (FHCMHC) Paid a Related-Party \$27,193 in Excess of What is Allowed by State Regulations: On December 11, 1985, TNC, Inc., (TNC) was formed in accordance with MGL, Chapter 180, to own certain land and buildings and subsequently lease this property to FHCMHC. Both corporations are organized as not-for-profit and are exempt from federal and state taxes under Section 501(c) of the Internal Revenue Code.

During our review we found that the relationship between FHCMHC and TNC clearly constituted a related-party relationship as defined by RSC. However, during fiscal year 1990, FHCMHC paid TNC a total of \$118,576 in rental payments for two program sites located on Pleasant and Bridge Streets in Northampton that we determined was \$27,193 in excess of what

was allowable under state regulations (i.e., in excess of what TNC's costs were for providing this space). Therefore, FHCMHC overbilled the state by this amount.

FHCMHC Paid \$18,291 in Excessive Depreciation Costs on Property It Sold to and Leased Back from Its Related Party: In August 1980 FHCMHC purchased a house located on West Street in Amherst for \$57,350 with a mortgage of \$56,000, which it used to house its state-funded program. The mortgage FHCMHC had on this property was for five years, expiring in August 1985. However, on June 13, 1985, FHCMHC paid off this mortgage and therefore did not have to make any further principal or interest payments on the mortgage subsequent to that date.

In August 1987, FHCMHC sold this property to its related party, TNC, for \$180,000 (realizing a gain of \$122,650 on the sale). TNC, in turn, leased this property back to FHCMHC at a cost of \$20,400 per year, and FHCMHC continued to operate its Amherst Shelter for Adolescents program at this location.

As previously mentioned, FHCMHC paid off the mortgage on this property on June 13, 1985 and was therefore not incurring any principal or interest expenses relative to the operation of the property subsequent to that date. Therefore, the only occupancy expense the state was obliged to pay to FHCMHC for this property subsequent to that date was an annual depreciation expense of \$686 as well as any maintenance expenses relative to its operation, which during fiscal year 1990 totaled \$1,463, for a total of \$2,149. However, we determined that during fiscal year 1990 FHCMHC paid TNC a total of \$20,400 in occupancy costs for this property, which is \$18,251 in excess of what was allowable under state regulations.

Tri-County Provided a \$10,000 Loan to Agaric its Related Party: On November 16, 1989, the Board of Directors of TCYP voted to approve a \$10,000 loan to Agaric. The proceeds of the loan were to be used to pay off an outstanding loan Agaric had entered into with one of its financial institutions. Since this loan was not provided for in TCYP's budgets and since TCYP does not have any privately generated funds of its own to use, we considered this to be an unauthorized use of Commonwealth program funds and questioned the propriety and legality of such a transaction. On May 15, 1990 Agaric's board voted to pay back this loan, with interest.

TCYP Cross-Collateralized a \$500,000 Line of Credit for Its Related Party: In July 1989 TCYP requested an increase in its general line of credit from \$400,000 to \$500,000 from its lender bank. As a condition to approving the increase, the bank required a "cross-collateralization" agreement, whereby TCPY guaranteed Agaric's debt and Agaric guaranteed TCYP's debt. Clearly, this cross-collateralization agreement could place the Commonwealth in a poor position to recover any money if its vendor goes bankrupt. Also, financial difficulties encountered at one agency would cause both agencies to encounter financial problems, since each guarantees the other's debt. For example, if Agaric became delinquent on loan payments, the bank would request

payment from Agaric's guarantor (TCYP). Should TCYP, which has an accumulated deficit of \$160,000, be unable to come up with the payments necessary, the Commonwealth would be forced to absorb the debt to avoid disrupting clients' lives. Furthermore, this cross-collateralization agreement limits TCYP's choices in procuring property sites. Since TCYP is locked into using the Agaric properties because it guarantees the debt, it cannot readily choose another entity to provide property for program sites, should less expensive property be found.

Gandara Mental Health Center, Inc. (GMHC) Paid a Related Party \$30,364 in Excess of What Was Allowed by DPS Regulations: During fiscal years 1992 and 1993, GMHC leased two residential properties from a related party, Hispanic Resources Inc., (HRI) that GMHC used to house its DYS and DSS group homes. However, GMHC's lease payments exceeded by \$30,364 the allowable limits established by DPS regarding payments that can be made to related parties. As a result, GMHC owes \$30,364 to the Commonwealth.

Recommendation: As a result of the number and significance of the deficiencies noted in OSA audit reports during fiscal year 1993 DPS issued an informational document entitled "Related Party Relationships and Disclosure Under 808 CMR 1.02." This document defines what is meant by a "related-party" and also provides a worksheet to help service providers determine if they are involved in a related-party relationship in the conduct of their business activities. Also, during fiscal year 1993 DPS modified its Uniform Financial Statements and Independent Auditor's Report (UFR) and accompanying instructions to require more detailed reporting of expenses that are susceptible to misuse when associated with related party transactions. Finally, DPS amended 808 CMR 1.00 effective July 1, 1994 (fiscal year 1995). One of these amendments requires service providers to give prior notification of all related-party transactions (including the relationship of the related parties and a description of the nature and amount of the transactions) to DPS and their PPA and in the case of a program approved under MGL Chapter 71B (special education) to DPS, the Department of Education, and the PPA. Also, an amendment to 808 CMR 1.15 (8) limits the amount of payments to related parties to the lesser of either the related parties' actual costs (less any costs that would be considered non-reimbursable if incurred by the provider) or market price. These actions taken by DPS are responsive and appropriate, and will serve to better ensure that related-party transactions are adequately disclosed and their associated cost were limited in the UFR. However, DPS should also consider taking the following measures relative to related-party transactions:

- o Chapter 296 of the Acts of 1993 and DPS's proposed regulations will require service providers to disclose in advance all transactions between themselves and their related parties. Although disclosure is the first and important step relative to related-party transactions, DPS must also take measures to assess and evaluate the reasonableness of these transactions. This can be done in a number of ways including DPS audit staff on a sample basis, making site visits to selected human service providers to examine their related party activities and/or DPS developing specific guidelines relative

to audit tests that must be performed by service providers' private auditing firms in the conduct of their audits and reviews of the agencies UFRs. DPS should impose a penalty (e.g., a fine or potential debarment from bidding on state contracts) for any provider found to be in violation of DPS regulations relative to related-party transactions.

- o DPS should specifically prohibit certain related party activities (e.g., providing loans to or collateralizing loans for related parties) that could have a financial impact on the operations of the contracted service provider and require providers to demonstrate that all transactions with related parties, in order to be allowable, are at the lower of actual cost or fair market cost.
 - o DPS should continue to require and provide training on the proper identification and disclosure of related party transactions to service providers, private auditing firms, and other interested parties.
2. **DPS Has Not Established Effective Regulations or Guidelines Relative to Contracts Awarded by Service Providers. As a Result, Service Providers Are Expending Millions of Dollars on Questionable, Unallowable, and/or Unnecessary Contracted Goods and Services**

The state Legislature and various governmental agencies have enacted laws and regulations relative to the awarding and administration of contracts with which all state agencies must comply. For example, various sections of MGL, Chapters 30, 30B, and 149, establish specific contracting requirements for state agencies to follow when procuring construction and building-related services. Similarly, MGL Chapter 30B also establishes contracting requirements for state agencies that want to purchase services, equipment, and materials. These laws and regulations require state agencies to conduct an open, fair, and competitive procurement process on all procurements over a specified dollar amount, and to document the fact that the process established by these laws and regulations was followed. These "public bidding laws" and regulations relative to the procurement of services promulgated by state agencies serve to ensure that there is open and fair competition for contracted goods and services and, consequently, that the state gets the best available products for the lowest responsible cost.

In contrast, state laws or regulations do not require contracted social service providers doing business with the state to follow any contracting procedures or to exercise sound business practices in procuring goods, services, or other items purchased with state funds. As a result of this lack of regulatory guidance, we noted at 12 (30%) of the 40 social service providers we audited significant contract administration deficiencies totaling over \$2.5 million. Some of the more serious problems we found at contracted service providers included the noncompetitive awarding of hundreds of thousands of dollars in state-funded contracts, in some cases to relatives or other related parties; inadequate maintenance of written contracts for the purchased goods or services; deficient contract language; unreasonable and/or unnecessary consultant services being procured, full time staff of providers being hired by the provider as consultants; consultants being paid without submitting bills; and consultants being given loans and advances prior to their rendering any services. Examples of some of the problems found at service providers follow:

Hillside Resource and Management Corporation, Inc.'s (HRMC) Inadequate Controls over Contract Administration Resulted in a \$184,000 Questionable and Unnecessary Consultant Contract Being Awarded to the Treasurer of HRMC's Board of Directors, an Additional \$81,613 in Contracts Noncompetitively Awarded, and \$34,209 in Services Purchased without the Benefit of a Written Contract: During our review, we found that HRMC had not established and implemented policies and procedures relative to the administration of its contracts. Rather, HRMC's Executive Director told us that he used his own judgment when awarding contracts and often contracted for services with a handshake rather than by signing a formal written contract. As a result, we found a number of problems with HRMC's contracts, including HRMC's noncompetitively awarding a contract totaling \$184,000 to the treasurer of HRMC's Board of Directors and its noncompetitively procuring services totaling \$81,613. Four of these services, totaling \$34,208, were procured and provided without the benefit of a written contract. Because HRMC had not established and implemented adequate internal controls over its contract administration process, it cannot be assured that state monies funding these contracted services were expended in compliance with all applicable state and federal laws, rules, and regulations or that expenses billed by HRMC against its state contracts to pay for these contracted services were reasonable, allowable, and allocable to state contracts.

Youth Opportunities Unlimited Inc., (YOU) Noncompetitively Awarded an \$87,267 Contract: During fiscal year 1990, YOU provided M & N Building and Remodeling Contractors Inc., of Raynham (M&N) a total of \$87,267 in funds that YOU received under its state contracts to renovate one of YOU's program sites located in Berkley. During our review we noted the following deficiencies in YOU's contract administration activities relative to this contract:

- o Contrary to sound business practices, the M&N contract was not awarded using a competitive bidding process. In fact, according to YOU's comptroller, YOU did not even advertise for price quotes from other contractors for this project. Because YOU did not use a competitive procurement process in obtaining these services, it cannot be assured that it received the highest-quality services at the lowest cost.
- o YOU's Board of Directors is responsible for reviewing and approving all of the corporation's expenses. However, according to the minutes of the March 7, 1990 board meetings, YOU's board approved only \$75,000 for the project, \$12,267 less than the projects actual cost. Consequently, there is no written evidence to support that YOU's board was aware of and had approved all the expenses associated with this project.
- o M&N paid two subcontractors \$13,542 and \$20,850, respectively to perform electrical, plumbing, heating, and air conditioning work. Although the plumbing, heating, and air conditioning contractor provided a written price quote to M&N for this work, there was no evidence that M&N solicited competitive bids for this subcontracted work, and there was no written contract or agreement between M&N, YOU, and the subcontractors that clearly delineated the scope of the work to be performed and the compensation to be provided. Without evidence of competitive bids, written agreements, and detailed invoices, YOU cannot be assured that it received the highest-quality services at the lowest price or that all the services billed for were necessary, appropriate, and actually provided.

Cape Cod Alcoholism Intervention and Rehabilitation Unit, Inc., (CCAIRU) Incurred Unreasonable and Unnecessary Consultant Costs Totalling at Least \$51,000: During our review, CCAIRU's Board of Directors voted to provide an annual annuity of \$25,000 to its former Executive Director. Subsequent to this vote, the audit team advised CCAIRU's board that this expenditure was not a reimbursable cost under state contracts. As a result, CCAIRU's board voted not to establish this annuity but rather to hire the former Executive Director back as a consultant at a sum not to exceed \$51,000 per year. However, this contract only requires the former Executive Director to be available to provide services and states that he will receive his full compensation, \$51,000, regardless of whether or not he provides any services to the agency. Specifically, Section D.3 of the contract states, in part:

CCAIRU agrees to pay consultant for services performed under this Agreement at the rate of \$4,250 per month whether or not services are actually rendered during the term of the agreement.

This consultant contract was provided to the former Executive Director as a means of giving him continued compensation upon his retirement and was not based on any determination of the agency's need for consultant services. In fact, as stated above, the contract does not require the former Executive Director to perform any services in order to receive \$51,000 in annual compensation from CCAIRU. Therefore, these costs are clearly unnecessary.

Gardner Athol Area Mental Health Association Inc.'s [GAAMHA] Inadequate Controls over Contracting Resulted in Questionable Payments Totalling at Least \$33,600 Being Made to Former Executive and Workshop Directors for Contracted Services: We examined the costs incurred and revenues being generated in GAAMHA's state-funded Beech Hill Workshop Program and determined that not all of the revenue that GAAMHA was generating as a result of the work being done in this program was being received by GAAMHA and being used to offset the amount of funds the state provided to GAAMHA to operate this program. Specifically, we found that on March 13, 1990 GAAMHA entered into a six-month contract (effective March 1, 1990 through August 31, 1990) with Blue Sky Productions, Inc., (Blue Sky) of Arlington, Virginia. According to the information we reviewed at GAAMHA, Blue Sky was formed in 1987 and is under contract with the Korean government to import, clean, and package old weapons for resale to collectors. Under its contract with Blue Sky, clients in GAAMHA's Beech Hill Workshop Program were supposed to clean, roll stamp, record serial numbers, and package weapons for Blue Sky. Additionally, GAAMHA was required to provide the following services:

1. Office space and storage of M1 rifles, carbines, and all materials incidental thereto.
2. Clerical and secretarial duties, including phone answering, and typing.
3. Handling of repairs and returns of rifles and carbines, excluding gunsmithing.
4. Use of a FAX machine.

In return for these services, Blue Sky agreed to make payments in the following manner:

1. For secretarial/clerical services, repairs, and returns: a total of \$2,800 per month payable directly to GAAMHA's former Executive and Workshop Directors.
2. For office space, storage, and all other costs: a total of \$2,000 per month payable to GAAMHA.

We found that GAAMHA's Board of Directors did not require GAAMHA's former Executive Director to obtain board approval for all contracts that he entered into on behalf of the agency. According to the minutes of GAAMHA's board meetings, the board was not aware of this agreement until 1991. At this time, GAAMHA's former Executive Director indicated that both he and the former Workshop Director were compensated directly by Blue Sky for certain services because he perceived that there was some risk of a liability suit being filed against GAAMHA if its clients were involved in repairing and returning these weapons. However, prior to this contract with Blue Sky, GAAMHA had an additional contract with a company called A&M Enterprises, under which GAAMHA received all the revenue for services relating to the Blue Sky contract. Additionally, according to the minutes of GAAMHA's board meetings, all work related to this contract, including the secretarial/clerical, repair, and return functions, were done on-site and, as far as could be determined, by workshop program staff during GAAMHA's normal working hours. Consequently, since the Commonwealth and GAAMHA incurred all the expenses associated with GAAMHA's contract with Blue Sky, all the revenues associated with this contract, including the \$33,600 (we determined these two individuals received \$2,800 per month for at least 12 months) in funds provided to the former Executive and Workshop Directors, should have been paid directly to GAAMHA and used to offset the state's funding of this program.

Beverly Children's Learning Center Inc., (BCLC) Expended \$4,550 for Questionable Consultant Services: Our review revealed that BCLC expended \$4,550 for what were described on its invoices as weekly (since 1988) outpatient psychotherapeutic services for the Executive Director. According to regulations promulgated by the state's Division of Purchased Services, any such costs, which are not directly related to the operation of the social service program being operated by the service provider, are considered to be nonreimbursable expenses to the provider.

BCLC's Executive Director contended that the consultant services provided to her were program-related because the consultant gave her advice on administrative matters and "evaluated her performance." However, despite the Executive Director's contention, she was unable to provide us with any documentation to substantiate that the services provided by the consultant were in any way related to the operation of BCLC's day care program.

Because there is no evidence to substantiate that the services provided by this consultant were directly related to the social-service-program purposes of BCLC, the \$4,550 paid to the consultant is a nonreimbursable program expense and should not have been charged against BCLC's contract with DSS.

Community Systems Inc., (CSI's) Contract with Its Affiliated Company Resulted in Questionable Costs: CSI awarded annual contracts to its affiliated company, Community Systems and Services, Incorporated, (CSSI) of Virginia, to provide it with various management services on a per diem basis. However, because the same three individuals constitute both CSI's and CSSI's Board of Directors, an "arm's-length" relationship to ensure the integrity of the contract between CSSI and CSI did not exist. In view of the relationship, and the fact that the per diem rate of compensation paid to CSSI for these services increased 100% from \$500 to \$1,000 in two years, we reviewed the language of the contracts between these two entities. We determined that these annual contracts did not contain adequate controls (e.g., specific terms, conditions, and scope of services containing measurable tasks and reporting requirements) to ensure that the level of services contracted for was necessary and reasonable or that the services provided by CSSI were allowable and allocable to the contracts. We also found that CSSI did not adequately document all the services it said it had provided or the consultant fees it had charged. This lack of documentation is of particular concern, given the relationship between CSI and CSSI. Specifically, we noted the following problems with this contract:

- o These contracts did not contain adequate controls (i.e., scope of services with measurable objectives or reporting requirements), thereby making CSSI's performance under this contract essentially unmeasurable and providing no assurance as to the reasonableness and appropriateness of expenditures made. For example, although the contract states that CSSI has the responsibility for the overall supervision of the programmatic and fiscal affairs of CSI, it does not require CSSI to record any documentation (e.g., supervisory notes or personnel evaluations) that would substantiate that it had adequately provided these services.
- o According to CSSI officials, one of CSSI's staff periodically travels up from the Virginia office, consults with CSI's Executive Director, and performs site visits to CSI's residential programs. Although CSSI officials were able to provide us with travel documentation for site visits to CSI, they could not provide us with any site-visit review summaries, notes, or other reports documenting the services that were provided during each visit.
- o CSSI's contract does not require it to provide CSI with information supporting its per diem rate, such as actual total cost figures, financial statements, or a summary of how it estimates the number of days necessary to provide its contracted services. Without such documentation, DMR cannot ensure that the management consultant fees paid to CSSI under the contract are (1) competitive compared to other fees charged in the open marketplace, (2) necessary and appropriate to CSI's cost of operations, and (3) allowable under state regulations.

The Springfield YWCA Did Not Maintain Contracts for All Its Consultants Services, and Consultants Were Often Paid without Submitting Invoices Our review of the Springfield YWCA's practices and procedures governing the use of consultants revealed that the YWCA did not have consultant contracts on file for all consultants and that consultants were often paid without their submitting bills.

The YWCA paid seven individuals a total of \$38,590 (\$12,843 and \$25,747 during calendar years 1989 and 1990, respectively) for counseling and other administrative consultant services. We found, however, that (1) the YWCA did not have written contracts with all seven of these individuals and (2) four of these individuals were paid a total of \$20,296 without their submitting bills to the YWCA. Because the YWCA did not execute formal written contracts with these consultants and in some cases paid consultants without requiring them to submit invoices, neither the YWCA nor the Commonwealth can be assured that the consultant services that YWCA paid for during the period covered by our review were necessary, appropriate, or actually provided.

Recommendation: We urge legislation that would require contracted service providers to utilize a competitive bidding process when awarding contracts for supplies or services that are being paid for with state funds, given the significance and pervasiveness of the problems we found with the contract administration activities of service providers during our audits of these providers. However, pending statutorily requiring contracted service providers to follow specific contract administration guidelines established by the state, we recommend that DPS promulgate regulations that would establish specific contracting and administration activities that contracted service providers would be required to follow as a condition of doing business with the state. At a minimum, these regulations should require providers to (1) document their determination of need process (i.e., how they determined their specific need for particular goods or services and disclose the types and amounts of consultant services purchased in their UFR; (2) utilize competitive procurement procedures, which could vary depending upon the type and amount of goods and/or services that are being purchased, and document this process; and (3) execute formal written contracts with individuals and/or companies with whom they do business when the procurement exceeds a specified dollar amount (e.g., \$1,000).

DPS should also take the measures it deems necessary to ensure that any state-funded contract awarded by a service provider contains fundamental elements that would ensure that purchased goods or services were necessary and appropriate and that contracted services were delivered (e.g., contain clearly defined scope, terms, and measurable objectives. Also, providers should be required to maintain documentation as to how the rate of compensation specified in the contract was determined.

It is also pointed out that the Federal Office of Management and Budget (OMB) revised its Circular A-110 to establish new grants administration policies for various nonprofit organization that receive federal funds. These revisions which were effective May 30, 1994 require applicable nonprofit organization to establish a system for contract administration as well as written procurement procedures. According to DPS, this will affect approximately 50% of the social service providers doing business with the state. However, DPS should consider implementing our recommendations so that all service providers doing business with the state have efficient and effective contract administration systems.

3. DPS Should Establish Conflict-of-Interest and Antinepotism Requirements for Contracted Service Providers

MGL Chapter 268A, "the Conflict of Interest Law," establishes a minimum standard of ethical conduct for all state, municipal, and county employees and officials. The purpose of this law is to ensure that public employees' private financial interests and personal relationships do not conflict with their public obligations. This law prohibits public employees from becoming involved in a situation that could result in a conflict, or even give the appearance of a conflict of interest situation. The intent of this statute is to promote the public's confidence in the integrity of public officials.

Although public officials are specifically prohibited from being involved in, or even giving the appearance of being involved in, a conflict of interest situation, no such requirement exists for the staff or board members of contracted service providers who are operating programs with public funds. According to members of the State Ethics Commission's (SEC) legal staff with whom we spoke, MGL Chapter 268A does not apply to staff¹⁵ or members of the Board of Directors of contracted service providers.

Because there is no established standard "code of conduct" for service providers to follow, we found many instances that were conflict of interest situations. For example, we found several instances where agency officials hired several immediate family members to work in management or other positions in their agencies. For example, at one provider, an individual employed as the agency's production manager had, during the course of his employment, as many as five of his immediate family members working for the agency, some under his direct supervision. Unlike the laws and regulations that govern the conduct of public officials, there are no laws and regulations that prohibit service providers from hiring family members. We also found many instances where individuals became members of the Board of Directors of service providers, and then directed business from this service provider to their place of business.

The following are detailed examples of some problems (in addition to those mentioned above and those detailed in Regulatory Deficiencies No. 1 and 2) that we found at service providers relative to the behavior of certain provider officials and officers.

Youth Opportunities Unlimited Inc., (YOU) Provided \$231,695 in Funds under a Contract with the Treasurer of Its Board of Directors to Oversee a Construction Project: During fiscal years 1988 and 1989, YOU provided Service Building Corporation (SBC) of Raynham a total of \$231,695 in state funds to act as the general contractor in the construction of a 12-room school house in Berkley. During our review of YOU's contract administration activities relative to

¹⁵ The State Ethics Commission was established in 1978 by the state legislation as an independent Civil Enforcement agency to enforce the requirements of MGL 268A. According to SEC officials, certain individuals working for contracted service providers may be considered "special state employees" and would be subject to the provisions of MGL Chapter 268A.

this project, we noted, among other things, that the process used by YOU to award this contract was questionable. Specifically, the then-treasurer of YOU's Board of Directors was also the president and treasurer of SBC. YOU received proposals for this project from three companies. One company's proposal (Thomas-Young Associates) was submitted directly to a company owned by the board's treasurer, which was also submitting a bid on the project. The two other proposals were submitted to YOU and reviewed by YOU's Board of Directors. The companies that submitted proposals and the dates that they were submitted are as follows:

<u>Company</u>	<u>Date Submitted</u>	<u>Proposed Price As a Percentage of Total Costs</u>
Thomas - Young Associates of Marion	March 5, 1988	12%
Service Building Corporation of Raynham	March 9, 1988	8%
Construction Units, Inc., of Peabody	March 14, 1988	10.5%

Because SBC's president was the treasurer of YOU's board, he had the opportunity to review bids received for the project before submitting a bid from his own company, thereby giving the appearance that he used his position on YOU's board to obtain a competitive advantage relative to the awarding of this contract. Also, because SBC's president was also a member of YOU's board of directors there is the appearance that he could have used his position on YOU's board to influence YOU to award this contract to his company.

Gardner-Athol Area Mental Health Association Inc., (GAAMHA) Did Not Comply with State Laws, IRS Regulations, and Its Own Internal Policies and Procedures, and Made \$7,784 in Questionable Payments to the Sons of the Former Executive and Workshop Directors:

The Massachusetts General Laws prohibit certain employees from hiring individuals who are under 16 years of age. Specifically, MGL Chapter 149, Section 60, in summary states that no person shall employ a minor under 16 years of age or permit him to work in, about, or in connection with any factory, workshop, manufacturing, or mechanical establishment at any time.

However, we found, that during the period of our review, GAAMHA's former Executive and Workshop Directors hired their underage sons to work at GAAMHA's Beech Hill Workshop Program. According to the information we reviewed, the Executive Director's son was 11 years old when he became an employee of GAAMHA and was reimbursed a total of \$1,618 for 260 hours of service between July 8 to December 31, 1990. However, the documentation maintained by GAAMHA did not clearly indicate the tasks he performed and, in some cases, the actual hours that he worked. Specifically, we could find time cards to document only 128 of the 260 hours for which he received compensation from GAAMHA. Additionally, these time cards were initialled

by GAAMHA's former Executive Director as the supervisor, and the employee's signature line was left blank. Also, on December 10, 1990 the former Workshop Director submitted to the former Executive Director a "Request for Check" form for this individual. The reason for the payment request was listed as "132 hours at \$7.00 labor Beech Hill Workshop (9/08-12/23)." Therefore, this request for payment was for services that could not yet have been performed by his son, and there were no time records or other documentation provided by the former Executive Director to substantiate this request.

The former Workshop Director's son was 15 years old when he was employed by GAAMHA in February 1990 to work in the Beech Hill Workshop. Between February 1990 and March 1991, this individual was reimbursed a total of \$6,166 for 893 hours of service. As with the former Executive Director's son, the documentation that GAAMHA maintained relative to the hours this individual worked and the services he performed was inadequate. For example, GAAMHA could only provide us with time sheets signed by the individual and initialed by his supervisor (his father) to substantiate that he worked 192 of the 893 hours for which he was paid. For the remaining 701 hours, we were able to locate one "Request for Check" submitted by this individual for 264 hours of service. However, there were no time sheets to support this request, and it was submitted on December 10, 1990 for services provided between September and December 23, 1990, or 13 days prior to all the hours that were being billed were supposedly worked.

Recommendation: On December 2, 1992, the governor's office issued Executive Order No. 346, which established a policy that places certain limitations on the hiring of state employees by private companies contracting with the Commonwealth. While this Executive Order is a positive first step toward limiting certain conflict-of-interest situations that may exist between state agencies and contracted service providers, more comprehensive measures are needed to ensure the integrity of service provider activities as they relate to potential conflict-of-interest situations. We therefore recommend that DPS develop a comprehensive code of conduct with which all contracted service providers doing business with the Commonwealth must comply. This code of conduct should apply to all provider staff as well as members of their Board of Directors. Any provider found to be in violation of this code of conduct should be subject to debarment from state contracts, in accordance with Chapter 550 of the Acts of 1991.

4. Inadequacies in DPS Regulations Relative to Nonreimbursable Costs Resulted in Hundreds of Thousands of Dollars in State Funds Being Expended on Non-Program-Related and/or Other Nonreimbursable Items

As detailed throughout this report, we found numerous instances where providers paid hundreds of thousands of dollars for goods and/or services with state funds, which according to state regulations were nonreimbursable under state contracts. These problems were partly the result of inadequate monitoring by state agencies (see Systemic Problems No. 1). However, during the period of our review, DPS regulations relative to nonreimbursable costs did not

adequately ensure that state funds were being properly safeguarded. Specifically, 808 CMR 1.15, promulgated by DPS, defines what costs are nonreimbursable under state contracts with service providers. While most of the nonreimbursable costs identified in this section of DPS's regulations are reasonably clear, during the period of our review certain sections were ambiguous and difficult to apply. For example, 808 CMR 1.15, Section (1), (5), and (12), states that the following are non-reimbursable costs:

(1) Unreasonable Costs: Any amount paid for goods or services which is greater than either the market price or the amount paid by comparable agencies or governmental units within or outside of the Commonwealth.

(5) Certain Salaries and Consultant Compensation: Those salaries, wages, and consultant compensation considered to be excessive by the Division, in light of salaries, wages and consultant compensation of other comparable providers.

(12) Non-Program Expenses: Expenses of the provider which are not directly related to the social service program purposes of the provider.

As shown above, paragraph (1) of these regulations does not allow reimbursement for costs in excess of market prices or what comparable agencies or governmental units are paying for similar goods and services. However, this section is somewhat ambiguous in that it does not specifically define or give examples of costs that would be considered unreasonable. Also, there is no information readily available to apply the second stipulation of this regulation (i.e., greater than amounts paid by comparable agencies or governmental units within or outside the Commonwealth). Therefore, if an organization purchased an item at market cost, it would have to be deemed reasonable even though it may be excessive. In contrast, the federal government, in its Code of Federal Regulations (CFR) and Office Management and Budget (OMB) Circular No. A-122, specifically defines what an unreasonable cost is and details what costs are unreasonable and unallowable under federal contracts. For example, 48 CFR Chapter 1, Part 31.201-3(a) and (b) state that:

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. . . . What is reasonable depends upon a variety of considerations and circumstances, including (1) whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance; (2) Generally accepted sound business practices, arm's length bargaining and Federal and State laws and regulations; (3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees and the public at large; and (4) Any significant deviations from the contractor's established practices.

These regulations then continue to detail numerous specific costs (e.g., the cost of first-class versus coach air fare) that are unreasonable and, therefore, nonreimbursable under federal contracts.

In contrast, under DPS regulations that were in effect during the period of our review, a provider could arguably purchase or lease luxury vehicles or other items to use in its programs, and the state would have to pay for these vehicles and items as long as the cost of the purchase or

lease was at a fair market rate and the vehicles were used for program purposes. The following is an example of the type of problems we found during our review relative to applying 808 CMR 1.15(1).

Unnecessary Non-Program-Related Vehicle Costs Totaling \$93,245 at Gardner Athol Area Mental Health Association (GAAMHA): Our audit of GAAMHA and Transit revealed that between January 1988 and December 1991, a total of \$93,245 was spent on leases for vehicles that were used by various program and administrative directors and that were not used for specific programmatic purposes.

The following chart provided by GAAMHA officials indicates the types of vehicles leased during this period, the cost of these vehicles (through December 31, 1991) that were charged against GAAMHA's contract with the Department of Mental Retardation (DMR), and the management personnel using the vehicle.

<u>Employee</u>	<u>Type of Car</u>	<u>Period of Lease</u>	<u>Monthly Lease</u>	<u>Lease Expense</u>
Executive Director	1990 Lincoln Continental	8/90 to 8/91	\$659	\$ 9,408
Fiscal Director	1988 Chrysler New Yorker	9/88 to 8/92	\$422	13,514
Workshop Director	1989 Limited Edition Trans Am	1/90 to 5/91	\$647	11,004
Assistant Workshop Director	1988 Oldsmobile Cutlass	7/88 to 4/91	\$400	13,598
Pathway Director	1988 Monte Carlo SS	1/88 to 9/90	\$375	12,373
Pathway Director	1989 Oldsmobile Toronado	7/89 to 5/91	\$575	13,219
Workshop Director	1988 Corvette	4/88 to 10/89	\$690	13,104
Executive Director	1988 Caprice	1/88 to 2/89	\$446	6,238
Unknown	1988 Monte Carlo SS	1/88 to 2/88	\$393	787
Total Expense				<u>\$93,245</u>

As a result of these deficiencies, the OSA recommended that GAAMHA remit to the state the \$93,245 that it expended on these vehicles because, although they could not be deemed unreasonable because of the difficulty in applying DPS's regulations, they were clearly non-program-related expenses and therefore unallowable under 808 CMR 1.15(12). As evidenced

by this fact, these regulations did not adequately protect the state from service providers who choose to run their operations extravagantly rather than in the most economical and efficient manner.

Regarding Paragraph (5) of 808 CMR 1.15, this section of the regulation did not effectively control the use of consultant services by contracted service providers during the period of our review. Specifically, although this regulation, to some degree, limited the amount of compensation that a provider can pay a consultant, it did not state under what conditions providers can procure consultant services, or who is eligible to provide these services. In contrast, state laws and regulations that apply to state agencies specifically state that a state agency can only procure consultant services if it can demonstrate that it needs expertise that cannot be provided by state employees. Moreover, such individuals must demonstrate that they are qualified to provide such services, and the services must be provided on a temporary basis. However, these regulations do not require service providers to meet any of these conditions when procuring consultant services with state funds. Additionally, in order for consultant compensation to be deemed nonreimbursable, it must be determined to be excessive by DPS. However, the information provided to DPS by contracted service providers (i.e., UFRs) only show a lump sum for consultant expenses and do not provide the level of detail that would allow DPS to independently make this determination. As a result, we found many instances where providers procured unnecessary and duplicative services and/or hired family members to provide such services (see Regulatory Deficiencies No. 2). A further example of problems we found relative to service providers' use of consultants in addition to those already mentioned in this report follows:

Nonotuck Resource Associate's (Nonotuck) Executive Director Provided \$8,000 to His Sister-In-Law for Consultant Services: During the period January 1992 through June 1992, Nonotuck provided an interior design consultant, the sister-in-law of Nonotuck's Executive Director, with \$8,000 in funds that it received under its state contracts to coordinate and select furnishings and related home accessories for three newly established residences for mentally retarded clients. This consultant contract was not awarded using a competitive bidding process, nor was there any written agreement signed relative to these services.

We recommended that Nonotuck establish and implement better internal controls over its contract administration process and that DPS determine the reasonableness of these consultant costs. However, we could not recommend that DPS recover these funds, because we could not readily apply DPS's criteria 808 CMR 1.15(5) to determine if the amounts paid to this consultant were excessive and therefore nonreimbursable under state regulations. Further, since consultant cost information provided to DPS in service providers' UFRs are in total and therefore do not lend themselves to this type of comparative analysis, DPS cannot make this determination. Currently, although this regulatory control exists in practice, it is ineffective and seldom, if ever, can be applied.

Finally, Paragraph 12 of these regulations needs to be more clearly defined. The way it is written gives service providers the opportunity to argue that any expenses they incur are allowable since they are related to the operation of their agency and therefore related to the social service programs that the provider operates.

Unreasonable, Unnecessary, Wasteful, and Unallowable Legal Consulting Costs Totaling \$96,260 at Goldberg Medical Associates Inc., (GMA): During the period of our review, GMA billed and was reimbursed by DOC for \$96,260 in legal expenses, which included litigation over the dissolution of the partnership between GMA's Medical Director and his prior partner and legal services rendered in responding to questions raised by the House of Representatives Committee on Post Audit and Oversight (HCPAO) relative to DOC's audit of GMA. However, GMA's contract with DOC did not specifically allow for these types of legal expenses, which consisted of the following:

- o GMA extended, and DOC reimbursed, \$5,563 for litigation services connected with a partnership dissolution agreement (dated November 30, 1984) between GMA's Medical Director and his prior partner.
- o GMA paid \$90,697 to a law firm for assistance in preparing and reviewing financial documents before transferring them to HCPAO, which requested them.

Regarding the \$5,563 in legal expenses for the 1984 dissolution agreement, the Medical Director told us that he believes that the dissolution agreement he had with his former partner directly affected GMA's contracts with DOC and that this expense should therefore be reimbursable under GMA's contract with DOC.

Regarding the \$90,697 that GMA paid a law firm, GMA and DOC officials stated that they believed that these fees were related to the provision of services under GMA's contract with DOC. They added that this arrangement for these legal services was mutually agreed upon by GMA and DOC officials as well as officials from HCPAO. In this instance, the OSA disagreed with GMA's position that these legal costs were program-related and recommended that GMA remit the \$96,260 that it billed for these services back to the state. However, because of the way this section of DPS's regulation is worded, GMA as well as any service provider can argue that any cost incurred by the provider is in some way program-related thereby making this section of the regulation difficult to apply and therefore ineffective.

Based on the issues raised in our reports relative to nonreimbursable costs, DPS has taken some measures to more effectively monitor and control state funds that are expended on nonreimbursable items. Specifically, prior to fiscal year 1994, DPS required service providers to merely disclose in their UFRs the amounts of all state and federal nonreimbursable expenses. DPS did not require providers to disclose in detail the nature of their nonreimbursable expenses or the source of funds that would be used to pay for these expenses. Consequently, there was insufficient data being collected by DPS from providers to monitor provider's nonreimbursable expenses. However on April 9, 1993, DPS issued new contract forms and instructions to be used by state

agencies and service providers in the contracting process during fiscal year 1994. Attachment B of these forms, entitled Nonreimbursable Cost Program Offset Schedule, requires service providers to disclose various data relative to their nonreimbursable costs and the source of funds that will be used to offset these costs to the state purchasing agencies. In August 1993, DPS issued a summary sheet (DPS - A035-93 Rev.), which further defined reimbursable and nonreimbursable costs. In this publication, DPS also provides its interpretation of what types of costs would be considered nonreimbursable in accordance with their regulations. Also, during fiscal year 1993 DPS amended its regulations to include the following as a nonreimbursable cost:

Unallowable Costs under OMB Circular A-122 and A-21: Costs which are not allowable under OMB Circular A-122 and A-21 are non-reimbursable to programs which receive Federal financial assistance.

Finally, as a result of our audit work, DPS amended its regulations effective July 1, 1994 (fiscal year 1995) to include the following as nonreimbursable cost.

- (23) Luxury Items. All costs associated with luxury items, including, but not limited to, luxury passenger automobiles as defined in sections 4001 or 4002 of the Internal Revenue Service Code, airplanes, boats, vacation homes, alcoholic beverages, charitable contributions and donations, and all non-program entertainment expenses.
- (24) Salaries of Officers and Managers. Salaries of officers and managers to the extent they exceed the rate paid to state managers in job group M-XII, step seven in the schedule contained in MGL c.30, s. 46C. For example, if the maximum salary level in the state's management schedule is \$80,000 and a provider's chief executive officer earns \$100,000 and spends 25% of her time on a social service program under 808 CMR 1.00, reimbursement would be limited to \$20,000 (\$80,000 maximum rate x 25% = \$20,000).
- (25) Mortgage Principal. Mortgage principal on an amortized or other basis: no purchasing agency shall reimburse a provider for the principal portion of any note secured by a mortgage on property owned directly or indirectly by the provider.
- (26) Undocumented Expenses. Costs which are not adequately documented in light of the American Institute of Certified Public Accountant's statements on auditing standards for evidential matters.
- (27) Administration and Support Costs. Costs which are otherwise non-reimbursable under the provisions of 808 CMR 1.15 may not be reimbursed through administration and support.

Recommendation: The actions taken by DPS in response to this issue were comprehensive, timely, and appropriate. However, DPS should take additional measures to fully address our concern relative to this matter. These measures include the following:

1. Amending 808 CMR 1.15(22) to be applicable to all state-funded programs and not just those that receive federal financial assistance.

2. In systemic problems at the State Agency Level No. 2, we make specific recommendations as to how to improve the controls the state has over consultant services purchased by service providers. In addition to the measures suggested in this audit result, we also recommended that DPS amend 808 CMR 1.15(5) to require that in order for a particular consultant service to be reimbursable under a state contract, the provider, at a minimum, must be able to demonstrate the following to its PPA and DPS:
 - o There was a definite measurable need for the service that could not be provided by the providers existing staff.
 - o The rate of compensation is at fair market.
 - o There is a contract for these services that delineates all the terms and conditions of the agreement including measurable deliverables.
 - o The consultant is qualified to provide these services.
3. Amending 808 CMR 1.15(12) to be more specific, e.g., making nonreimbursable any expense for which the provider cannot demonstrate that an expense directly benefitted a state-funded program, and was not directly related to the social service program purposes of the provider's state contracts.
4. Continue to require and provide training to providers, private auditing firms, and other parties involved in the state's POS system as to what costs are nonreimbursable and unallowable under state contracts.
5. DPS should also consider strengthening certain aspects of this section of its regulations as follows:

For example, Federal Acquisition Regulations 31.201-3(A) puts the burden of proof as to the reasonableness of an expense on the contractor i.e., service provider, by stating:

If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's Representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.

DPS should consider clearly establishing in its regulations reasonableness criteria and that the burden of proof as to the reasonableness of an expenditure is on the service provider.

5. DPS Should Develop Regulations or Guidelines Relative to the Composition and Activities of the Boards of Directors of Service Providers

Section 6A of MGL Chapter 180, entitled Corporations For Charitable and Certain Other Purposes (commonly referred to as the Public Charities Law), empowers nonprofit organizations to make, amend, and repeal corporate bylaws. These bylaws can prescribe the number of board members an organization wants to oversee its operations; the manner in which these members will be elected to serve as board members; their terms of office; and their powers, duties, and responsibilities. The Board of Directors of a service provider is the primary organizational body that ensures that the agency meets its operational objectives in the most effective and efficient manner. Board members perform a variety of key functions, including overseeing the overall operations of the agency, setting policies and procedures to ensure agency objectives are met, and

hiring the agency's top executive. Although the Boards of Directors is a key component to the successful operation of an agency and its programs, the Commonwealth¹⁶ has not established any regulations or requirements relative to the general composition or conduct/activities of board members. As a result, during our audits of service providers, we found a number of problems with board members' actions (as discussed in other sections of this report), as well as in actions by board members relative to meeting their oversight responsibilities. For example, we found a number of instances where board members either engaged in questionable activities (see Regulatory Deficiencies No. 1 and No. 3 of this report), and at three providers YOU, HRMC, and GAAMHA board members were not adequately meeting their oversight responsibilities for their respective agencies. We also found several instances (e.g., at Road to Responsibility Inc., Behavioral Research Institute Inc., and the Institute for Developmental Disabilities Inc.) where the majority, if not all, of the members of an entity's Board of Directors during some point of our audit period were family members and/or employees/consultants to the agency. Under such circumstances the ability of these boards to independently and effectively govern the activities of the agency is questionable. An example of inadequate oversight by a service provider's Board of Directors follows:

Inadequate and Undocumented Oversight Activities by Youth Opportunities Unlimited Inc., (YOU) Board of Directors, and Insufficient Financial Data Provided to Board Members: According to YOU's corporate bylaws, the members of its Board of Directors are responsible for overseeing and managing the activities of the agency. In order to ensure that its board members meet their responsibilities, these bylaws require the board to hold and attend meetings at regular intervals and to formally document in written board minutes any decisions made by the board. These bylaws also require that board members be routinely informed about YOU's revenues and expenses.

However, we found that the members of YOU's Board of Directors did not effectively meet their oversight and management responsibilities or properly document their operational decisions. Specifically, we found the following problems relative to the board's activities:

- o Of the 42 board meetings that should have been held between July 1, 1987 and December 31, 1990, 14 were either not held or did not have a quorum of board members present to properly conduct the business of the agency. One board member, the vice-president, was

¹⁶ Although DPS has not established regulations or guidelines relative to the activities of board members or officers of a corporation, Chapter 180 of the Massachusetts General Laws requires directors, officers, or incorporators of nonprofit charitable organizations to exercise their duties and responsibilities in good faith and in the best interests of the corporation. However, this statute does not specifically address the composition of boards or related-party transactions between board members and providers. The Office of the Attorney General has also issued a guide to help board members of charitable organizations be aware of and exercise their responsibilities, entitled, The Attorney General's Guide For Board Members of Charitable Organizations.

not in attendance for 14 of the 32 meetings that were held while he was a board member. Between February and August 1990, this member missed five consecutive meetings. There was no evidence that this individual provided a reasonable explanation for these absences to the other board members and no evidence that this individual was asked to forfeit his position on the board in accordance with the provisions of YOU's corporate bylaws. (On September 26, 1990, this board member resigned from the board.)

- o There was no record of board approval for at least \$264,000 in capital expenditures YOU made during the period of our review. Additionally, the minutes of the board meetings were not signed by the board's clerk, who is responsible for certifying that the minutes accurately represent the discussions held and the decisions made by the board during its meetings.
- o Contrary to YOU's corporate bylaws, there was no evidence to substantiate that the treasurer, Executive Director, or any other individual provided detailed reports on the revenues and expenditures for each of YOU's accounts at each board meeting.
- o Although on April 25, 1990, the board voted to allow YOU's Executive Director to enter into a two-year lease for space in which to operate the Network School Program, on June 19, 1990, YOU's Executive Director entered into a five-year lease for space for this program. There was no evidence that a quorum of YOU's Board of Directors approved of this change in the term of the lease.

Recommendation: DPS should develop and implement regulations or guidelines relative to the activities of a service provider's Board of Directors. At a minimum, these guidelines should address the following: (1) composition of the board and selection of board members, e.g., minimum number of board members and prohibitions on managers or staff of service providers from board members and if board members should be selected by a board member selection committee or elected by existing board members; (2) disclosure of board members' financial interests in other companies doing business with the Commonwealth and/or other service providers during business with the state; (3) prohibitions on board member activities e.g., any conflict-of-interest/antinepotism regulation as recommended in Regulatory Deficiencies No. 3 of this report; (4) requirements of board members to hold and attend regular board meetings at specified intervals and to clearly document the board's activities at these meetings as a condition of doing business with the state; and (5) penalties for any social service provider found to be not in compliance with these regulations or guidelines.

6. DPS's Regulation Relative to the Amount and Use of Surplus Revenues by Service Providers Needs to Be Re-examined and Modified

Under regulations (CMR 114) promulgated by RSC, there was no specific provision that allowed contracted service providers to retain any surpluses (excess revenues over expenses) they realized as the result of operating state-funded programs. However, EOHS had what it called a Fiscal Procurement Resolution Policy. This policy allowed providers doing business with EOHS agencies to incur what it called a nonprofit maintenance expense (NPME) and retain revenues based on this expense. The allowable NPME was an amount equal to no more than 5% of the cumulative public revenues over expenses that the provider realized from its state

contracts for the reporting period (fiscal year). This amount could accumulate or be carried forward from year to year up to an amount equal to 10 weeks of the provider's working capital. Any revenues that a provider realized in excess of these specified limits could be either recovered by the PPA, or the PPA, through negotiations with the provider, could allow the provider to use it for program purposes. According to EOHS's Fiscal Procurement Resolution Policy "this expense recognizes the need to stabilize the community based system as a means of insuring that client services are not jeopardized by a provider's limited capital resources." The problem with this policy was that under certain conditions a provider's NPME was factored into its subsequent year's unit rate of reimbursement calculation as available revenue. This had the effect of reducing the amount of funds the state would give to the provider to operate the program and defeat the primary purpose of this policy, which was to ensure that service providers were adequately capitalized.

As pointed out in the Background section of this report, in 1990 the Assistant Secretary of the former Office of Purchased Services issued his final report on the POS system. One of the concerns raised in this report was the undercapitalization of service providers:

Most providing agencies suffer from undercapitalization. Over 25% of the providers are technically insolvent. This condition threatens the very survival of the provider and thereby, the continued delivery of services. Adjusting downward next year's rate paid by the state absorbs any surplus resulting from managerial efficiencies. The provider begins every year as a financial start-up, facing the same risks that any start-up company incurs. This makes the provider system vulnerable and fragile.

As a result, there is a pervasive inability of providers to acquire fixed assets or accumulate working capital - the very resources necessary for any business entity's survival. Moreover, this is a costly way of doing business. Not only are we constantly bailing out providers who are in a chronic deficit position, also force expensive leasing solutions for facility and equipment needs, instead of encouraging capital acquisition.

In order to address this concern, DPS promulgated 808 CMR 1.19(3), which allows providers to retain a certain percentage of their surplus state revenues by stating (as amended effective July 1, 1994):

Not-for-Profit Provider Surplus Revenue Retention: If, through cost savings initiatives implemented consistent with programmatic and contractual obligations, a non-profit provider accrues an annual net surplus from the revenues and expenses associated with services provided to purchasing agencies which are subject to 808 CMR 1.00, the provider may retain, for future use, a portion of that surplus not to exceed five percent of said revenues. The cumulative amount of a provider's surplus account may not exceed twenty percent of the prior year's revenues from purchasing agencies. Surpluses may be used by the provider for any of its established charitable purposes, provided that no portion of the surplus may be used for any non-reimbursable cost set forth in 808 CMR 1.15, the free care prohibition excepted. The Division shall be responsible for determining the amount of surplus that may be retained by each provider in any given year and may determine whether any excess surplus shall be used to reduce future prices or be recouped.

These regulations appear to have addressed the concerns raised by the Assistant Secretary of the former Office of Purchased Services relative to the undercapitalization of service providers. However, DPS regulations should exert more control over the amount of surplus funds service providers can retain and how providers can expend these funds. Our specific concerns are discussed in Sections A and B that follow.

A. DPS Should Further Restrict the Generation and Use of Surplus State Revenues Provided to Service Providers: Prior to fiscal year 1993, 808 CMR 1.19(3) did not place any restrictions on how surplus state funds service providers realized from their state contracts could be spent. As previously noted, during fiscal year 1993 DPS placed some control over how service providers could expend these funds by adding the words "for charitable purposes" to this section of its regulations. However, this restriction is too general and does not adequately safeguard state funds. For the most part providers told us that they were of the opinion that any surplus funds they accrued from the operation of their state-funded programs were no longer state funds and could therefore be used by the agency at its own discretion. Based on our audit work and subsequent to our audit field work, DPS amended its regulations effective July 1, 1994. These regulations prohibit service providers from using any funds that would be considered nonreimbursable under 808 CMR 1.15.

B. DPS Should Reexamine the 5%/20% Surplus Allowance for Reasonableness: As noted above, DPS allows providers to retain up to five percent of their annual surplus revenues and up to 20% of their prior year's gross state revenues as a total accumulated surplus amount. According to DPS officials, this 5%/20% surplus allowance was established as the amount of excess or surplus funds a provider should be allowed to retain to cover its inflationary costs and provide sufficient funds for the providers' planned growth and capitalization. However, DPS should examine the appropriateness of this level of surplus allowance. First, the primary intent of this regulation is to provide an adequate level of funding to service providers so that these providers can have sufficient capital to operate state-funded programs. Prior to fiscal year 1982, state regulations did not allow service providers to be reimbursed for capital costs, such as depreciation and mortgage interest. Subsequent to this date, RSC regulations came into effect that allowed service providers to capitalize and recover a significant portion of their real estate costs by being reimbursed for their depreciation and mortgage interest expenses. Also, for new programs and some existing programs, service providers are given capital budgets in addition to their regular program budgets to purchase assets (e.g., furnishings and equipment) to use in their programs. Consequently, even without DPS's surplus allowance, service providers are able to recover a significant portion of the costs associated with their investments in real property and other capital assets, and are often provided with funds in addition to those needed to provide program services to purchase furnishings and equipment items. Second, according to statistics published

by Dunn & Bradstreet, during calendar years 1992 and 1993, the median return on assets¹⁷ for social service providers (both for-profit and not-for-profit) was 3.7%. Therefore, the up to 5% surplus revenues DPS allows service providers to retain may be excessive when compared to industry norms.¹⁸ Third, DPS regulations only limit the amount of state revenues over expenses a provider can retain on its state contracts and does not take into consideration any other revenues a provider may be receiving or expenses it may be incurring through its non-state-funded activities. Therefore, providers may be generating sufficient surpluses on their non-state-funded activities to ensure the adequate capitalization of their entity without the state's revenue surplus retention allowance. According to information provided to us by EOHHS, during fiscal year 1993, 181 (21%) of 850 of its contracted service providers realized surpluses of corporate revenues over expenses of greater than 5%.

As of the end of our audit field work, DPS was in the process of implementing a new formula for calculating the amount of surplus revenue retention for each provider. On January 20, 1994, a memorandum was issued by the Assistant Commissioner of DPS to all interested parties relative to DPS's Surplus Revenue Retention Policy. This memorandum stated that the division will calculate a provider's surplus, as follows:

For purposes of implementing 808 CMR 1.19(3), the annual surplus under review will be limited to Commonwealth funds including funds from cities and towns for special education programs, as defined below. DPS will use the financial information documented in the UFR as reported on Supplemental Schedules A and B. DPS will determine the percentage of Commonwealth revenue supporting the provider on a program-by-program basis (total of lines 7,8,11, 16-200 and 22-35 on Schedule A: Supplemental Revenue Schedule). The total of Commonwealth revenue will be divided by total agency revenue, (line 58) for each program. This calculation will yield an allocation percentage to be applied to the reimbursable surplus or deficit for each program (as reported in Schedule B: Supplemental Expense Schedule, line 47 plus the sum of Lines 43 and 44). DPS will then calculate a grand total for the Commonwealth revenue and a grand total for the allocation of Commonwealth surplus and deficit from the sum of all of the programs. The percentage of the surplus/deficit allocated to the Commonwealth is calculated by dividing the grand total of the Commonwealth surplus/deficit by the grand total of the Commonwealth revenue. If this percentage is less than or equal to five percent then the provider may retain the funds pursuant to 808 CMR 1.19 (3).

¹⁷ A common profitability ratio (surplus revenue) used in industry is return on assets which is calculated as follows:

$$\text{Return on assets (ROA)} = \frac{\text{net income after taxes}}{\text{average total assets}}$$

¹⁸ This figure was derived from statistics published in Dunn & Bradstreet's Analytical Services Industry Norms and Key Business Ratios: 1992-1993. The figures used in this calculation were for business engaged in the provision of social, residential care, child day care, job training, and individual family services.

Although cost reimbursement funds are included in the formula for the determination of total funds, it is a violation of state finance law for Commonwealth cost reimbursement agreements to accumulate surpluses. Any surplus attributable to or generated by Commonwealth related income and expenses in cost reimbursement contracts will be subject to recoupment.

Our review of this formula disclosed some problems. Specifically, according to the January 20, 1994 memorandum from DPS's Assistant Commissioner, the intent of surplus revenue retention is to "allow providers reasonable and acceptable possibilities for increased capitalization." However, DPS's proposed formula does not include any surplus revenue a provider generates from all other sources (e.g., non state contracts, interest income, and fundraising activities). As a result, under this formula the state could be providing funding in excess of a provider's reasonable and acceptable capitalization needs. Also, generally accepted accounting principals advocate that proper accounting requires revenue to be matched with expenses for each accounting period. This formula employs inconsistent accounting methodologies for establishing unit rates of compensation and surplus revenues. Specifically, revenues from all sources are used in determining a program's unit rate of compensation, but only state revenues are used to determine the program's surplus revenues.

Recommendation: In order to ensure that state funds are properly safeguarded, DPS should take the following measures relative to its Not-for-Profit Provider Surplus Revenue Retention Policy:

- A. Reexamine the 5%/20% revenue retention allowance for reasonableness as compared to nonprofit industry standards and adjust these percentages, as necessary. Also, DPS should include all unrestricted sources of revenue that providers generate into their revenue retention allowance.
 - B. DPS should require service providers to account for the source and use of surplus revenues they receive from their state contracts in a separate fund and prepare an annual statement of changes in fund balance that specifically identifies the sources and uses of funds from this account. Moreover, service providers should be required to submit this audited financial statement to DPS along with its UFR.
7. **DPS Regulations Should Define Minimum Internal Control Standards and Require Service Providers to Document Their Internal Control Systems**

According to standards published by the American Institute of Certified Public Accountants, it is the responsibility of management to establish and maintain an effective internal control structure. Good internal controls are essential in maintaining full accountability for resources and in achieving management objectives in the most effective and efficient manner.

During fiscal year 1989, the state Legislature enacted Chapter 647 of the Acts of 1989 which was proposed by the State Auditor. This statute defines the minimum level of quality acceptable for internal controls systems to be established and utilized by state agencies. Paragraph (a) of this legislation states:

Internal control systems of the agency are to be clearly documented and readily available for examination. Objectives for each of these standards are to be identified or developed for each agency activity and are to be logical, applicable and complete.

Documentation of the agency's internal control systems should include (1) internal control procedures, (2) internal control accountability systems and (3) identification of the operating cycles. Documentation of the agency's internal control systems should appear in management directives, administrative policy, accounting policies, and procedures manuals.

In order to assist state agencies in meeting the requirements of this statute, the Office of the State Comptroller (OSC) has issued an Internal Control Guide for Departments, which provides essential information to state agencies as to the importance of good internal controls, key internal control concepts, and control objectives. Although under this statute state agencies are required to develop, implement, and document adequate internal control systems over their operations, no such requirement exists for contracted service providers doing business with the state.

Each year contracted service providers are required to have an audit conducted in accordance with generally accepted government auditing standards (GAGAS) and submit the UFRs that are produced as a result of this audit to DPS. During these reviews, auditors are required by GAGAS to obtain an understanding of an entity's internal control structure and report on any condition or material weaknesses in this structure that would have a material impact on the information in an entity's general purpose financial statements. However, the purpose of these reviews is to express an opinion on the general purpose financial statements of an entity, and not an opinion of the entity's internal control structure. In fact, standard reporting language for this type of review would be as follows:

In planning and performing our audit of the general-purpose financial statements of (name of entity) for the year ended June 30, 19__, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control structure.

According to Office of Management and Budget (OMB) Circular A-133, certain providers who receive over a specified amount of federal financial assistance as detailed in this circular are required to have a "Single Audit." This audit includes a review of all programs funded by state and other sources. These audits are done in accordance with GAGAS but, in addition to the regular GAGAS reports, OMB Circular A-133 requires additional reports including one called Single Audit Report on the Internal Control Structure used in Administering Federal Financial Assistance Programs. The objective of this part of the review is to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that were relevant to preventing or detecting material noncompliance with the specific and general requirements applicable to the major federal financial assistance programs of a service provider. However, these types of reviews are limited in that they only evaluate internal controls as they pertain to an entity's major financial federally assisted programs and are not intended to give an opinion on the overall adequacy of the internal control systems of a service provider. In fact we found a standard excerpt from a report on the Internal Control Structure used in Administering Federal Financial

Assistance Program to read as follows:

Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion. . . .

Our consideration of the internal control structure policies and procedures used in administering federal financial assistance would not necessarily disclose all matters in the internal control structure that might constitute material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the the internal control structure elements does not reduce to a relatively low level the risk that noncompliance with laws and regulations that would be material to a federal financial assistance program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Given these facts, clearly these are no comprehensive reviews being done of the internal control systems established by service providers over their operations. As such, we found numerous problems with the internal control systems at 33 of the 40 (83%) of the service providers we visited. One example of the type of problems we found follows:

Nauset Workshop, Inc., (NWI) Inadequate System of Internal Controls over Financial Transactions and Furnishings and Equipment Resulted in Inadequate Assurance that Transactions Were Properly Authorized, Recorded, and Reported and that Assets Were Safeguarded: We found that NWI did not establish and implement formal written procedures relative to its accounting and payroll activities, did not delegate accounting tasks to several different individuals involved in the accounting cycle, did not maintain adequate documentation to substantiate its revenues and expenditures, and did not maintain detailed records of its inventory. As a result, NWI could not be assured that its financial assets were safeguarded or that its financial transactions were properly authorized, recorded, and reported. A brief description of the internal control problems at NWI, follows:

Discrepancies in the Recording of Assets and Liabilities:

- o NWI's general ledger showed that on this date NWI had \$117,335 in cash, while NWI's bank account reconciliations as of this date showed that NWI had a cash overdraft of \$89,387 (a net discrepancy of \$206,722).
- o NWI's accounts payable and receivable balances, according to NWI's general ledger, were \$201,682 and \$152,645, respectively as of December 31, 1990. However, NWI officials could not provide detailed subsidiary records identifying debtors and creditors for these accounts. Additionally, the accounts payable and receivable balances according the interim financial statements prepared by NWI as of December 31, 1990 were \$261,635 and \$197,130, respectively, differing from NWI's general ledger figures by \$59,953 and \$44,485.
- o NWI's general ledger showed on December 31, 1990 that total liabilities and fund balances were \$2,370,308, while the total assets were \$2,385,369 (a variance of \$15,061).

Lack of Segregation of Employee Duties:

- o NWI's former Business Manager had sole responsibility and authority over all of NWI's business and accounting transactions, which include distributing payroll, signing checks, disbursing cash and checks, preparing bank deposits, and reconciling NWI's bank accounts.

Inadequate Record Retention and Documentation to Support at Least \$99,352 in Expenditures and \$435,438 in Revenues:

- o We found that NWI was not maintaining its financial records for six years in accordance with DPS's General Contracting Conditions. NWI could not provide us with adequate documentation--and in some cases any documentation--to support expenditures it made during the period of our review. For example, we requested documentation to support a statistical sample of 78 expenditures totaling \$141,425 made by NWI during our audit period. Of these 78 expenditures, NWI could not provide us with invoices to support 51 of these expenditures, totaling \$99,352, or with cancelled checks for 19 of these expenditures, totaling \$32,086. In instances where our audit tests required NWI to provide us with voided non-issued checks, NWI officials were unable to do so and told us that not all checks issued by NWI were listed in the check disbursement journal, nor was it NWI's practice to retain all voided checks.
- o NWI officials told us that it does not keep subsidiary records of receipts from clients for room, board, and tuition, which according to NWI's financial statements amounted to \$93,759 and \$118,056 during fiscal years 1990 and 1991, respectively. Also, NWI officials could not provide us with any detailed records identifying gifts and grants it received from private organizations or individuals. According to NWI's financial statements, during fiscal years 1990 and 1991 it received \$111,669 and \$111,954, respectively, in revenue from these sources.

Discrepancies in Payroll Records Resulted in \$37,592 in Questionable Expenditures:

Based on our review of 398 timesheets submitted by NWI staff for a two-week payroll period, we noted the following problems:

<u>Description</u>	<u>Number of Checks with Deficiencies</u>	<u>Total Amount Disbursed</u>
No timesheet to support payment	9	\$ 8,069
No supervisory approval on time-sheets	38	29,306
Employee hours paid were different from hours worked as recorded on timesheet	17	217
Total	64	<u>\$37,592</u>

Recommendation: DPS should develop an internal control guide for service providers similar to the one issued by the Office of the Comptroller to assist state agencies in meeting the requirement of Chapter 647, and provide this to all contracted service providers. In addition, DPS should amend its current regulations and require service providers, based on this guide, to develop and implement an adequate internal control structure and submit a standard form with their UFR each year documenting this structure.

8. DPS Should Clarify Its Regulations Relative to Lobbying Costs

Prior to the establishment of DPS and during the first years of DPS's operation, state regulations clearly prohibited service providers from using state funds to lobby members of the state Legislature. For example, Section 1.15(18) of DPS regulations 808 CMR, which became effective August 2, 1991, stated that the following was a nonreimbursable expense under state contracts.

- (18) Lobbying Costs. Funds used to pay lobbyists, consultants, or staff to lobby members of the General Court, or their staff, or to lobby regulatory bodies, and any costs associated with lobbying activities.

Subsequent to promulgating these regulations DPS amended certain sections of its regulations. Regarding lobbying costs, effective November 20, 1992, DPS issued new regulations that stated that the following lobbying costs were nonreimbursable under state contracts under 808 CMR 1.15(18).

- (18) Lobbying Costs. Funds used to compensate or reward lobbyists, consultants or staff to promote, oppose, or influence legislation, or influence the governor's approval or veto thereof or to influence the decision of any member of the Executive branch where such decision concerns legislation or the adoption, defeat, or postponement of a standard, rate, rule or regulation pursuant thereto, and any costs associated with lobbying activities. This prohibition shall apply where the lobbyists, consultants or staff, as any part of their regular and usual employment and not simply incidental thereto, attempt to promote, oppose or influence legislation, approval or veto, or regulations, whether or not any compensation in addition to the salary for such employment is received for such services.

As can be seen, the prohibition on lobbying activities currently applies to lobbying activities unless they are incidental to the individual's regular and usual employment, as opposed to all lobbying activities as was the case in DPS's prior regulations. Since the term "incidental" is not further defined in DPS regulation, the prohibition on lobbying has become more ambiguous in that service providers could now use state funds to lobby and argue that their lobbying activities were incidental to their regular job of providing social services to clients.

In fact, during our audit of one human service provider, a member of a law firm representing the provider contended that these lobbying expenses his client incurred were allowable, by stating the following in a December 22, 1993 letter to the Office of the State Auditor:

This regulation [808 CMR 1.15 (18)] was ambiguous, at best, as to whether or not lobbying costs are disallowed when the person who is engaging in the lobbying (whether as an employee or consultant) does it as a regular part of his or her employment as opposed to an "incidental" part of his employment or consulting services.

Since it has never been a regular or usual part of the job of any . . . employee or consultant to engage in lobbying activities, I believe that there was no error for failure . . . to report disallowed lobbying expenses. Judicial decisions mandate that in promulgating regulations, administrative agencies set forth "with particularity and precision what contact is prohibited so that persons of ordinary intelligence would have no doubt about exactly what is required to be done to comply with the express terms

of the rule or regulation. Cella, Administrative Law and Practice, Sec. 746, vol. 49 at p. 135." See, also, Druzik v. Board of Health of Haverhill, 324 Mass. 129 (1949). This rule has particular force when there are criminal sanctions for violation of the rule. . . .

Under these circumstances, I believe that it would be totally unfair for your report to criticize BRI for not reporting "lobbying" expenses in the face of a regulation which is subject to such vagueness and ambiguity. As I stated in our meeting, there are many other DPS rules which are ambiguous.

Recommendation: In some instances it may be beneficial for the state to allow contracted service providers to pay for lobbying activities. For example, federal cost principles for nonprofit organizations as contained in OMB Circular A-122, allow contracted service providers to incur lobbying expenses relative to influencing state legislation to avoid material impairment of service providers' authority to perform its grant, contract, or other agreement with the federal government. We therefore recommend that DPS amend 808 CMR 1.15 (18) and make this regulation clearer by stating specifically under what circumstances lobbying costs will be allowed.

OTHER ISSUES

In addition to the systemic and regulatory problems we found within the state's POS system, we also found several significant technical/operational problems within the system. These problems are discussed in detail in sections 1 through 4 below:

1. **DPS and State Agencies Have Not Developed and Implemented Measures to Evaluate the Effectiveness of Component Pricing, and There Are Several Problems with DPS's Component Pricing Catalogue. As a Result, State Agencies That Choose to Utilize Component Pricing May Be Paying Millions More for the Same or Even Fewer Program Services without Any Improvement in the Quality of These Services**

As mentioned in the Background section of this report, DPS has developed a Component Price Catalogue (CPC) that state agencies can use in developing program budgets. Effective fiscal year 1994, DPS promulgated its CPC into regulations (808 CMR 3.00), and each state agency that chooses to utilize component pricing in its contracting process must disclose this fact in its Request for Proposals (RFPs) for contracted services and comply with the conditions of 808 CMR 3.00.

According to an October 5, 1988 report issued by the Office of Purchased Services (OPS), component pricing is an attempt to establish pricing procedures and a pricing system for social service programs that is compatible with the following 11 principles.

1. **Client Focus** - The pricing system should function to maximize direct benefits to clients from available dollars.
2. **Administrative Feasibility** - The pricing methodology must be administratively practicable from the standpoints of the pricing authority, the purchasing departments, and the providers. Pricing should not disrupt or delay ongoing procurement processes.
3. **Fairness** - Pricing methodology must support the Commonwealth's commitment to pay a "fair price" for services.

4. Competition - Generally, the competitive forces of supply and demand are the best regulators of price, quality and quantity. To the extent feasible in the human service arena, pricing should rely on these free market forces.
5. Diversity - The pricing approach should respect the real world diversity in purchasing arrangements and markets for various human service programs.
6. Least Cost - The pricing approach should result in the lowest cost to the Commonwealth consistent with maintenance of program quality and financial integrity.
7. Incentives - The pricing system should encourage economy, efficiency, and superior performance.
8. Provider Management - The methodology should leave all matters of financial management to the provider's judgment.
9. Price Follows Program - Programmatic matters are the exclusive province of the contracting parties. The role of the pricing authority should be to price the program which the parties have designed.
10. Budget Control - The pricing methodology must be compatible with departmental budget and expenditure control. The pricing system must integrate with the budget development system in such a way as to permit "bottom up" budgeting.
11. Timeliness - Rates should be promulgated prior to the contract start date.

According to information that we received from DPS, component pricing was implemented because it affords service providers the opportunity to benefit from effective and efficient management. Specifically, purchasing agencies (that choose to utilize a component pricing methodology) and service providers negotiate the cost of each program component (e.g., staff salaries) that will be reimbursed under the program contract. If the service provider can actually provide the services for less, then it is entitled to retain a certain percentage (see Regulatory Deficiencies No. 6, which discusses surplus revenue).

Various information distributed by DPS also states that component pricing was developed and implemented for several other reasons. First, it is supposed to be a fairer, simpler, more market-based way of pricing contracts. Second, it is supposed to allow state purchasing agencies to cease "micro-management" of providers' fiscal matters. Third, and most importantly, component pricing was introduced to address the "client comes first" concept. By providing service providers with market-based reimbursements for program components, it was expected that providers could improve the effectiveness and efficiency of their state-funded programs, which could potentially translate into improving the quality of services being provided to clients in these programs.

We found a number of problems with component pricing and DPS's component pricing catalogue, as follows:

A. Neither DPS nor State Agencies Have Developed or Implemented Formal Policies or Procedures to Assess What Effect, If Any, Component Pricing Has Had on Program Services: During fiscal year 1992, DPS strongly encouraged state purchasing agencies to implement component pricing, and in fact requested agencies to submit a component pricing plan. According to a March 31, 1992 memorandum issued by DPS's former Assistant Commissioner:

Agency plans should include a discussion of the results of the agency's own analysis of the projected costs associated with this initiative, as well as a discussion of the steps to be taken by the purchasing agency to address increased costs, where they are shown to exist. There should also be some discussion of the agency's current efforts to incorporate and monitor client-based outcome measures. Finally, each agency should make a concrete recommendation for implementing component pricing principles in all or some significant part of its base service procurement activities for FY'93. These plans should be submitted to DPS and to EOHHS prior to the systematic release by purchasing agencies of Requests for Proposals (unless alternative arrangements have been agreed upon by EOHHS and DPS).

In response to this memorandum, 10 state agencies and one secretariat (the Executive Office of Elderly Affairs) provided information about their implementation of component pricing to DPS. Of these 11, three did not give an estimate of how much additional funding they would need to implement component pricing, and one agency, the Department of Public Welfare, estimated that during fiscal year 1993 it would cost between 15% to 20% more for the contracts that were scheduled to be rebid during this fiscal year. The remaining seven agencies gave estimates of their projected program cost increases that would result from implementing component pricing, which totaled \$9,952,000 over the next one to three years.

In order to deal with these increased costs DPS suggested that state agencies (1) reprioritize their base services and eliminate the amount or level of those services deemed less critical to the agency's mission and (2) reduce or adjust service intensity (e.g., develop less expensive service models). However, in their responses to the March 31, 1992 memorandum from DPS, a number of these state agencies expressed concerns over the quality of services their agencies would be able to provide if they implemented component pricing, as follows:

The Executive Office of Elder Affairs stated, in part:

At a minimum for FY'93, the impact of implementing Component Pricing will likely result in insufficient Administrative monies to authorize and maximize the use of Home Care Purchase Service dollars.

The Massachusetts Rehabilitation Commission stated, in part:

contracts, to be bid in FY'94 for FY'95, would be seriously affected by Component Pricing as it is currently applied. After careful analysis of the EEP budgets, using Component Pricing methodology, we have determined that the program would be significantly impacted by a conservative estimate of increased costs in excess of \$600,000, reflected in an upward adjustment of unit rates. These increased rates would represent the displacement of over 200 clients and the loss of approximately 33,300 units of service. This FY'93 estimate would, undoubtedly, grow over time with inflation. Over the past three years, due to budget constraints, the census for this program has shrunk by more than 200 clients. The use of Component Pricing would result in still further reductions in the client census.

Similarly, the Massachusetts Commission for the Blind stated, in part:

Cost of Implementing Component Pricing for FY'93. At present, the Commission for the Blind is conducting discussions with the vendor selected by competitive bidding for the component priced contract that the agency is negotiating for the current fiscal year. If the number of units of service, rather than the components making up the service, are diminished then the number of rehabilitations achievable under SDG number 4 will diminish proportionately.

Estimated Cost of Implementing Component Pricing for FY'94. Turning 22, community services and vocational rehabilitation programs, which make up the bulk of the purchased service dollars at the agency, have been maximized to service eligible clients such that any increase in cost would produce decreases in the number of units of service delivered and projected outcomes.

Based on this information, it is clear that implementing component pricing is going to cost the state considerably more funds for the same level services that they are currently paying. In fact, a fiscal year 1991 report issued by DPS states, in part:

The impact of implementing Component Pricing as a viable methodology within the Purchase of Service System would cost the Commonwealth an additional \$200 million at a minimum and \$600 million at a maximum, while maintaining existing levels of service

However, neither DPS nor the state agencies we audited have developed or implemented procedures to correlate service inputs (funding) to processes (service quality) and outputs (services) in a manner that effectively monitor's program services (see Systemic Problems No. 1) and assesses what effect, if any, component pricing is having on program services (e.g., improving the quality of program services by reducing provider staff turnover ratios). Since this pricing methodology may be forcing state agencies to pay more for program services without increased funding, thereby causing them to eliminate or "scale down" services clients are already receiving, the negative consequences of implementing component pricing may outweigh the positive aspects of this methodology.

Although the CPC is used to establish salaries of program staff, there are no mechanisms in place to ensure that these salaries are actually paid to these individuals. The UFRs submitted by service providers to DPS show salary expenses only in totals by positions. DPS does have ancillary controls that allow it to investigate programs whose staffing levels (full-time equivalent staff persons) fall below 90% of the budgeted amount (see Systemic Problems No. 2). However, there are no monitoring procedures in place to ensure that providers ultimately pay their staff persons the salaries they negotiated using the CPC. As such, DPS and the Commonwealth cannot be assured that component pricing is meeting this intended purpose of ensuring that program staff are being equitably compensated, thereby serving to improve the quality of program services by allowing service providers to hire and retain more qualified people and reduce staff turnover.

In its response to DPS's March 31, 1992 memorandum, DMH expressed a similar view to ours by stating in part:

The principal of component pricing whereby the Commonwealth must pay at the component price minimum whereby the provider can then pay less. This can lead to increased fund balances for Providers if these higher salaries do not have to be paid to the employees on line item. One may argue this practice does not guarantee "fair market" or equal pay for provider staff. . . .

B. Component Pricing is Not a Feasible or Equitable Way of Pricing Contracts:

According to DPS officials, the original intent of component pricing was to establish fair market prices for all program components and to have all state agencies use these component costs in establishing program budgets. However, subsequent to the first CPC being developed, DPS officials told us that they realized it was not feasible for them to establish fair market prices for all program components (e.g., rents), since rental costs would vary greatly depending on the geographic location and particular space needs of programs.

Currently, the majority of program component price ranges (e.g., for payroll taxes, fringe benefits, and transportation) are not established within the CPC, but rather are negotiated. Essentially, the only program components that are established with the CPC are certain salaries of direct care staff (DPS officials told us that direct care salaries constitute on average about 70% of a program's cost), and the salary ranges for these components in DPS's component pricing catalogue ranged from 12% to 97%, from the lowest to the highest salary levels. For example, the salary range for a psychologist with a master's degree in DPS's CPC for fiscal year 1993 ranges from \$24,645 to \$47,084. According to DPS officials, these ranges are wide because they reflect salaries that are being paid in the marketplace to individuals who possess varying degrees of education and job experience. However, the CPC does not provide salary ranges for certain staff positions such as the Executive Director (which may be considered an indirect cost) and program directors.

Moreover, the salary ranges presented in the CPC may not be as useful as they could be to state purchasing agencies that choose to utilize a component pricing methodology. Specifically, these salary ranges may not be specific enough to provide the information necessary for these agencies to negotiate fair salaries for staff positions. For example, DPS's CPC, provides only one salary range for a registered nurse, regardless of whether or not the nurse is providing services in a clinical program, residential program, or other setting. Also, an assistant program director's salary range is the same regardless of the type of program (e.g., day care, health care, vocational/educational, or residential treatment program) being operated. Since salary ranges in the CPC are wide and not program specific, the level of information may not be sufficient enough to allow state agencies to negotiate equitable (fair market) prices. Consequently, program costs may be more a reflection of the ability of a certain provider to negotiate rather than the specific service needs of a program.

Finally, both state, agency officials and officials from service providers doing business with the state have acknowledged that there have been difficulties in utilizing component pricing to

price POS contracts. For example, according to the minutes of a November 16, 1993 component pricing planning session attended by officials from DPS, EOHHS, DMH, DMR, MRC and various service providers, these officials concluded the following:

It was agreed that component pricing has been generally successful for new programs and for use in establishing the rules of the game. It has been difficult to implement for old programs because such programs have not been rebased and the purchasing agencies have been typically reluctant to cut services to improve program specific funding levels. Component Pricing did result in the simplification of budget pages to two pages. It has however not drastically changed the contract "negotiating" game; providers continue to "back into" budgets by downgrading personnel to have them fit into less expensive component categories or by supplementing the programs with other funds, or by reducing or deferring expenses in other component categories in order to comply with the salary requirements. The "negotiating" game can only really change if the state can provide more funds for existing programs, or can agree to truly reduce service levels. . . .

C. CPC Does Not Establish a Range of Profitability That For-Profit Organizations Can Realize on State Contracts: Prior to the establishment of DPS, RSC had established a range of profitability for certain social, rehabilitative, and educational programs in 114.5, CMR 3.01, which stated:

- (a) Beginning July 1, 1989 the earnings factor for a proprietary operating agency shall be six and 60/100 (6.6%) of the average equity capital.

This regulation defined average equity capital as follows:

Average Equity Capital. Average equity capital is the average of year end assets less liabilities for the reporting year and the year end assets less liabilities for the year prior to the reporting year. Where there has been a transfer of assets, a provider's allowable basis shall be calculated pursuant to 114.5 CMR 3.12.

However, DPS's Component Price Catalogue does not establish a limit for the amount of profit a for-profit human service provider can make on state contracts. During fiscal year 1993, DMR awarded 53 contracts to for-profit providers which totaled approximately \$21 million. Based on our review of information DMR provided to us relative to these contracts, none of these 53 contracts indicated the amount of profits these service providers were making on their state contracts. According to information we received from EOHHS, during fiscal year 1993, the executive office that accounted for the majority (approximately 74%) of all POS expenditures, awarded POS contracts totaling over \$62 million to 155 for-profit agencies (excluding transportation contracts).

Because DPS has not established an acceptable range for the earnings factor that a for-profit agency can realize, there is inadequate control over the rates of compensation being provided to for-profit service providers (see Systemic Problems at the State Agency Level No. 2).

Recommendation: Since component pricing has not been demonstrated as a less costly and viable contract pricing option, DPS should conduct a current cost-benefit analysis of the component pricing initiative. DPS should not fully implement or even advocate the

implementation of using component pricing until such a study has been conducted and reviewed by the appropriate state officials. In order to do this, DPS, in conjunction with other appropriate state agencies, should identify the significant quantitative and qualitative characteristics of the system, the pricing methodology, and program services that need to be measured in order to make this analysis, and how these characteristics will be used in this analysis. DPS, in conjunction with the appropriate state agencies should then develop and implement either agency-specific or systemic policies and procedures for collecting and analyzing this information. Such an analysis should, at a minimum, attempt to correlate program inputs to the different processes or program types used to provide services to program outcomes.

If, based on this review, DPS determines that component pricing is an effective and efficient method of pricing state contracts, then it should take the following measures:

1. In order to ensure that this type of contract pricing can be effectively administered by DPS, the department should require that it be implemented system-wide. Once every state agency is using the same contract pricing methodology, DPS can justify allocating some of its limited resources to develop and implement system-wide controls over the process.
2. DPS should further refine the information in its CPC, as follows:
 - o Make the information more program specific by establishing salary ranges by service/program type, e.g., day care, educational, vocational and health care services.
 - o Establish within its CPC a salary floor for service provider's program staff. DPS should require the private auditing firms to conduct audit tests to ensure that providers do not pay agency staff salaries below this floor. This will allow providers to still benefit from efficient management practices and at the same time maintain and potentially improve the quality of program services by reducing staff turnover and improving employee morale.
3. DPS should establish a POS data base showing program component costs by industry and by geographic location. DPS should not only use this information in developing/updating its CPC each fiscal year, but should also make this information available to each state purchasing agency. This information in addition to the historical cost information detailed in each service provider UFR, could be used by state agencies in their contract negotiation process.
4. DPS should establish a reasonable profit range for POS contracts that applies to for-profit agencies doing business with the state.

If, based on its analysis, DPS determines that component pricing is not a viable contract pricing option, then it should develop a more efficient and effective approach to contract pricing.

2. The Financial Information Being Collected by DPS through Its UFR Process Is Incomplete and Is Not Being Effectively Utilized

As previously pointed out, prior to the establishment of DPS, contracted service providers who negotiated their unit rates of compensation as opposed to having their rates established by the State's Rate Setting Commission (RSC) were required to submit to RSC on an annual basis

various budgets (RSC 600-B) and cost reports (RSC 1100) to facilitate the negotiation of these unit rates. Under DPS, the reporting requirements for service providers has significantly changed. Specifically, instead of a service provider submitting a cost report and a program budget prepared by its management to RSC, with exception (see Footnote No. 11), each service provider must now complete and file with DPS a standardized report called a Uniform Financial Statements and Independent Auditor's Report (UFR) for the just completed fiscal year before the 15th day of the fifth month after the close of the provider organization's fiscal year (typically, a provider's fiscal year ends June 30, so that the UFR would be due November 15). Under the UFR reporting requirements, human service providers are required to provide more detailed information than was required under their RSC reports relative to all aspects of their operations. Additionally, unlike RSC reports, providers are now required to have their uniform financial statements audited by a private auditing firm in accordance with generally accepted government auditing standards (GAGAS) and the fieldwork and reporting standards prescribed by the American Institute of Certified Public Accountants (AICPA).

The aforementioned changes to the reporting process made by DPS were appropriate and necessary and served to improve the potential efficiency and effectiveness of this reporting process. However, there are still several problems both with the information being reported within the UFR process and how this information is being utilized, as follows:

- o There is an inadequate audit trail between a provider's UFR that details the fiscal activities of a provider by individual programs and its contracts. State agencies award contracts but a service provider's program can be funded by several contracts, and/or one contract can fund several programs. However, since UFR information is reported by program it is extremely difficult for state purchasing and oversight agencies to monitor/analyze contract costs and to use this actual contract cost information in their contract negotiation processes. Currently, state contract forms have a space in which the provider can indicate the program number to which the contract relates, but this cross-referencing is not being consistently used by state purchasing agencies.
- o Not all service providers who are awarded POS contracts are required to file a completed UFR with DPS. DPS's UFR Audit and Preparation Manual under 808 CMR 1.00 (Audit Preparation Manual) identifies 14 exemptions to individuals or organizations in filing either complete or partially completed UFRs with DPS. For example, one exemption states "if your organization is not a Chapter 766 school and is required to file a report with any bureau of the Rate Setting Commission this year which encompasses total organizational expenses, as noted above, your organization is exempt." As such, under this exemption, a service provider may be providing the majority of its services through POS contracts that fall within DPS regulations, yet is required to file not a UFR with DPS, but rather applicable cost and other reports to RSC. According to DPS officials, during fiscal year 1993 DPS received approximately 900 (62%) complete UFRs out of 1,455 social service providers who did business with the state. Also, although the RSC performs comprehensive analyses of the reports it receives from its service providers, the information in RSC reports and the type of reviews the RSC performs on these reports is not the same as the information required by DPS's UFR or DPS's review process. For example, certain providers do not have the information in the reports they submit to RSC audited in accordance with GAGAS. Also, certain providers filing reports with RSC do not have to provide information (e.g., a detailed statement of functional expenses) and in some instances only have to provide information about a

specific program and not agency-wide information as is required by the UFR. Although the RSC's reports are effectively designed to meet the needs of the commission, they are, in many instances, not intended to be used as is the UFR to assessing each provider's compliance with applicable laws, rules, and/or regulations or assessing the internal control structure of service providers. As such, there is no consistent comprehensive POS data base that can be utilized as needed by state agencies to monitor and/or analyze program and contract costs.

- o DPS's review, input, analysis, and dissemination of UFR information is largely manual. DPS receives UFR information from service providers and manually inputs this data into its UFR database. Then, to the extent possible (see Systemic Problems at the State Agency Level No. 1), DPS manually conducts various reviews of this UFR information, such as analyzing financial data of providers that may be experiencing financial problems. This manual process is cumbersome and results in less timely and complete information being provided to state purchasing agencies.
- o Not all operational deficiencies that could have an impact on program services may be being identified and reported to DPS on UFRs. Specifically, 15 of the 40 service providers we audited were required to have their annual audits and UFR reviews done by a private auditing firm, in accordance with GAGAS and to provide a copy of this UFR to DPS. Of these 15, 12 submitted UFRs to DPS in accordance with state regulations that were not deficient. Although our audits of these 12 agencies were also done in accordance with GAGAS and covered the same audit periods as those audits performed by the agencies' private accounting firms, we noted 56 deficiencies within the operations of these organizations, while the private auditing firms noted only 18. Consequently, private auditing firms need more training on the conduct of GAGAS audits of social service programs.
- o According to the information we reviewed at the five state agencies (see Systemic Problems at the State Agency Level No. 1), the UFR information is only being used by principal purchasing agencies to pre-qualify service providers and is not being used for other purposes such as monitoring actual program costs and using this information in their contract negotiation process, which clearly result in an underutilization of this information.

Because of the problems we found with DPS' UFR process as noted above, the Commonwealth does not have a timely comprehensive, and useful POS data base available to effectively monitor and evaluate POS-related activities.

Recommendation: According to DPS officials, subsequent to the end of our audit field work, the RSC has voluntarily required some of its providers to submit to it a UFR in lieu of their required RSC report. However, additional measures should be taken to ensure the effective and efficient oversight of all human service providers doing business with the state. Specifically, we recommend the following:

1. UFR reporting should be mandated for all social service providers that receive state funding in excess of a minimum amount that should be established by DPS. This will streamline provider-reporting requirements and will allow DPS to maintain a complete data base of information for all providers that it can analyze, utilize, and share with all POS agencies.
2. DPS should establish an automated UFR database and reporting system. Such a system should require service providers to electronically file UFR information with DPS. This would significantly reduce the time and resources DPS currently expends on its UFR

data entry process and allow these resources to be redirected to other activities. In establishing this system, DPS should ensure that the system has an appropriate system of data checks for reasonableness and accuracy of the data transmission. Programs to routinely analyze UFR data should be made part of the system and the system should be set up as a network so that all POS agencies and RSC can access, but not manipulate, this data.

3. DPS should develop and implement a more formal method on the UFR of being able to correlate program costs to contract costs. Upon request, DPS should make this information available to state purchasing agencies and other interested parties. Also, many state officials, as well as officials at contracted service providers with whom we spoke, were dissatisfied with the UFR and the UFR process. In view of this, DPS may want to periodically solicit information from state agencies, service providers, and private auditing firms providing services within the POS system as to any problems, concerns, or criticism they may have relative to the UFR or the UFR process and make the appropriate changes to this process and documents, based on this information.
4. DPS should develop specific guidelines as to how state purchasing agencies should use UFR information provided to them by DPS, and DPS should conduct training sessions on this subject with state purchasing agency officials.
5. DPS should continue to provide and require training to private auditing firms relative to the conduct of GAGAS audits of social service providers.

3. Inefficiencies in the POS Contracting Process at Some State Agencies Resulted in Excessive and Unnecessary Costs

The process that state agencies are required to follow when procuring POS-related services is complicated, time-consuming, and requires state agencies and service providers to utilize significant resources to conduct this process. Specifically, according to DPS regulation 808 CMR 2.00, each POS contract, with a few exceptions, has to be rebid at least every five years in accordance with the state agency's predetermined procurement cycle plan. During each competitive procurement process, there are typically 12 steps that state agencies must follow in accordance with DPS regulations. These steps include the following:

1. Developing a Request for Proposal (RFP).
2. Solicitation of interested parties/public notification.
3. Holding bidders' conferences.
4. Receipt of proposals.
5. Screening proposals to determine if they met the minimum submission requirements of the RFP.
6. Establishing a proposal review committee to review and evaluate proposals.
7. Conducting negotiations with any and/or all bidders who submit qualified proposals.
8. Evaluating and ranking each qualified proposal.
9. Awarding the contract to the bidder who submits the most advantageous proposal.
10. Developing the contract documents.
11. Holding debriefing meetings with providers to discuss the state agency's award decision.
12. Participation in any administrative appeals that were initiated by aggrieved bidders.

The amount of contracts rebid each year by state agencies and the resources employed in this process are significant. For example, at DMR during fiscal year 1993, a total of 300 program contracts, representing over \$35 million, were awarded based on the RFP process. Given the amount of resources involved in the contracting process, state agencies should take measures to ensure that this process is performed in the most efficient manner.

However, during our review, we found that three of the state's largest human service agencies--DMH, DMR, and DSS--were not procuring POS services in the most efficient manner. Specifically, we found that these state agencies were awarding multiple contracts to their service providers. For example, during fiscal year 1993, each of DMR's service providers were awarded between one and 40 individual contracts, 194 of 375 (52%) had multiple contracts, and one service provider (Vinfen) had 85 individual contracts with only four different state purchasing agencies. Moreover, we found that many of these contracts awarded by these state agencies were to the same service provider for the same service type. For example, as shown in the table below, DMR awarded 23 different contracts to Advocates for Mental Health, Inc., to operate the same programs, Staffed Apartment I, in different geographic locations. Finally, we found that state agencies, in particular DMH, was awarding different contract types (i.e., negotiated unit rate, class rate, and cost reimbursement contracts) to the same service provider for the same services. The table below summarizes our review of the contracts awarded by DMH, DMR, and DSS to two service providers during fiscal year 1993.

Service Provider	State Agency	Number of Contracts	Description of Program	Contract Types		
				Class Rate	Unit Rate	Cost Reimbursement
1. Advocates for Mental Health, Inc.	DMH	3	Residential program for low-intensity clients	X	3	
	DMH	3	Residential program for high-intensity clients	X	3	
	DMH	5	Supported Housing	X	3	2
	DMH	4	Satellite Residential Program	X	2	2
	DMH	5	Crisis Intervention	X		5
	DMR	23	Staffed Apt. I	X	20	3
	DMR	5	Community Residences	X	5	
		<u>48</u>			<u>36</u>	<u>12</u>
2. Dare Family Services Inc.	DMR	15	Staffed Apt. I	X	10	5
	DMR	9	Specialized Homecare	X	6	3
	DSS	11	Partnership Agency Family Services	11		
	DSS	<u>25</u>	Family Based Treatment		21	4
		<u>60</u>		<u>11</u>	<u>37</u>	<u>12</u>

While we recognize that there may be a need to award different contracts for different program services, awarding multiple contracts to the same service provider for the same services using different contract types is inefficient in that it causes state agencies to unnecessarily utilize their limited resources to award and administer these different contracts and contract types.

Recommendation:

1. DSS, DMH, and DMR should reexamine their procurement activities relative to POS contracts and take the measures necessary to ensure that these services are procured in the most efficient manner. Further, given the logistics involved in the POS system (i.e., the number and types of contracted services being procured, the number of clients being served, and the amount of dollars being expended) the state should examine the feasibility of automating various components of the procurement process within the POS system. For example, the March 1993 edition of *Governing Magazine* noted that the State of Oregon had recently made a conceptual leap by stating "that the state should not be paying the vendors to do business with us." In other words, the state should not be incurring unnecessary costs just to solicit and procure business from contracted service providers. As a result, this article states that the State of Oregon automated its RFP process. This automation resulted in a significant reduction in costs associated with the state's RFP process, increased the number of proposals per contract Oregon received, and reduced program costs because bidders would examine all the information relative to the winning bids, which caused them to lower their bids during the next bid cycle to be more competitive.
4. **Contrary to State Law, the Administration Has Not Appointed All the Members of the State's Social Service Policy Advisory Board**

According to St. 1992, c.133, s.113, the governor is mandated to establish a Social Service Policy Advisory Board to assist the Assistant Commissioner of DPS in policy decisions (e.g., promulgation of regulations) relative to the POS system. However, we found that, as of February 15, 1994,¹⁹ the governor had not appointed all the members he was required to appoint to this board, as required by this statute. As a result, POS service users and contracted service providers cannot be assured that they have an equitable say in the manner in which the POS system operates.

According to St. 1992, c.133, s.113, there is supposed to be a Social Service Policy Advisory Board (Advisory Board) to assist DPS in its policy decision relative to the POS system. Specifically, this statute states:

There shall be a social service policy advisory board consisting of the secretary of health and human services or his designee, the secretary of elder affairs or his designee, the commissioner of education or his designee, a representative of the Massachusetts association of school committees who shall be selected by that organization, a representative of the associated industries of Massachusetts who shall be selected by that organization, a representative of the Massachusetts association of approved private schools who shall be selected by that organization, and twelve members to be appointed by the governor, one of whom shall be a representative of a provider contracting with one or more agencies within the executive office of health and human services, one of whom shall be a representative of a provider contracting with the executive office of elder affairs, one of whom shall be a consumer of services provided by one or more agencies within the executive office of health and human services, one

19 This information was provided to us by DPS subsequent to the end of our audit field work.

of whom shall be a consumer of services provided by an agency contracting with the executive office of elder affairs, one of whom shall be a representative of the Massachusetts superintendents of schools association or a special education administrator for a city or town of the commonwealth, and one of whom shall be a parent of a child with special education needs. Each appointed member of said board shall be appointed for a term of three years and may be reappointed; provided, that among the initial appointed members, four shall be appointed for a term of one year, four shall be appointed for a term of two years, and four shall be appointed for a term of three years. The chairperson of said board shall be selected by the governor and shall serve in this function for a term of not more than one year.

Said board shall meet quarterly and shall make recommendations to the assistant commissioner on matters of policy of the division. Except in the case of emergency regulations, at least thirty days before the promulgation of any proposed regulation, the assistant commissioner shall provide a copy thereof, together with an explanatory statement, to said board. The assistant commissioner shall give due consideration to comments on such proposed regulation submitted by said board or any members thereof.

We asked DPS officials to provide us with a current listing of Advisory Board members. Based on our review of this listing, we determined that as of February 15, 1994, the Advisory Board consisted only of seven of the 18 members required by this statute, and the governor had only appointed two of the 12 members he is required to appoint.

In this regard, DPS officials stated that DPS, in conjunction with the administration, was in the process of filling vacancies within the board. However, this board should have been fully established when this statute was enacted in 1992. Because, as of February 15, 1994, the Advisory Board has not been fully established, POS service users and contracted service providers cannot be assured that they have an equitable say in the manner in which the POS system operates.

Recommendation: The administration should comply with the requirements of St. 1992, c.133, s.113, and appoint all the members of the State's Social Service Policy Advisory Board. If, however, the administration believes that this advisory board would not be an essential part of the state's POS system, then it should take measures to repeal the legislation that established this advisory board.

SUPPLEMENTARY INFORMATION

In addition to the systemic, regulatory and other operational problems we found within the state's POS system, our review disclosed the following problem at one of DMH's area offices relative to POS activities. Because this deficiency is unique to DMH, we are disclosing it as supplementary information.

DMH's Metro Boston Office Did Not Comply with DPS's Rebidding Requirements for POS Contracts: According to state regulations, 808 CMR 2.11, state agencies are required to prepare a procurement cycle plan for the program services that they competitively procure from contracted service providers. These plans set forth the procurement schedules for each POS program type or service that the state purchasing agency procures. These regulations also establish procurement cycles for POS contracts by stating:

All procurement shall be subject to competitive procedures pursuant to 808 CMR 2.04, Request for Qualifications procedures pursuant to 808 CMR 2.05, or justification of non-competitive procedures pursuant to 808 CMR 2.06 at least as often as follows:

- A. In the case of Agreements exempted from competitive procurement on an emergency or temporary basis pursuant to 808 CMR 2.06(1)(a), according to the timetable set forth in the justification but at least annually;
- B. In the case of all other procurements, at least once every five years.

At DMH we found that its Metro Boston area office was not complying with DPS's competitive bidding requirements. Specifically, we reviewed the information relative to 16 contracts totaling \$12,238,093 that were in effect during fiscal year 1993. DMH staff did not know and could not provide us with documentation that indicated when 10 of these 16 contracts, totaling \$8,147,262, were last bid. Additionally, for two of these contracts (Nos. 26003600713 and 26003600419), DMH requested and received a waiver from DPS's procurement cycle regulation in fiscal year 1991, which according to DPS officials was for a one-year period. However, these contracts were not rebid during fiscal year 1992 and are not scheduled to be rebid until fiscal year 1996. According to DMH staff in this office, it was their understanding that a waiver to these regulations was in effect for the procurement cycle (i.e., five years) and therefore the contract did not have to be rebid until the next procurement cycle.

APPENDIX A
Audit Sites Visited

State Agencies:

1. Department of Youth Services
27-47 Wormwood Street, Suite 400
Boston, MA 02110
2. Department of Social Services
150 Causeway Street
Boston, MA 02114
3. Department of Correction
100 Cambridge Street, 22nd Floor
Boston, MA 02202
4. Department of Mental Retardation
160 North Washington Street
Boston, MA 02114
5. Department of Mental Health
25 Staniford Street
Boston, MA 02214

Service Providers:**Report Numbers:**

- | | |
|--|-----------|
| 1. Youth Opportunities Unlimited, Inc. (ComCare)
70 Main Street
Taunton, MA | 92-4271-3 |
| 2. Community Systems, Inc.
315 Cotuit Road
Sandwich, MA 02563 | 91-4257-3 |
| 3. Goldberg Medical Associates, Inc.
530 Loring Avenue
Salem, MA 01970 | 91-4012-3 |
| 4. Family Continuity Program, Inc.
460 Totten Pond Road, 4th Floor
Waltham, MA 02154 | 92-4309-3 |
| 5. Justice Resource Institute, Inc.
132 Boylston Street
Boston, MA 02116 | 92-4305-3 |
| 6. Old Colony Council, Boy Scouts of America
2428 Washington Street
Canton, MA 02021 | 92-4306-3 |
| 7. New Bedford Child and Family Services
1061 Pleasant Street
New Bedford, MA 02740 | 91-4260-3 |

APPENDIX A (Continued)

Audit Sites Visited

<u>Service Providers:</u>	<u>Report Numbers:</u>
8. Nauset Workshop, Inc. 895 Mary Dunn Road Hyannis, MA 02601	92-4300-3
9. Middlesex Shelter for the Homeless, Inc. 189 Middlesex Street Lowell, MA 01852	92-4315-3
10. Catholic Charities/North Surburban 55 Lynn Shore Drive Lynn, MA 01902	91-4259-3
11. Beverly Children's Learning Center, Inc. 4 Ocean Street Beverly, MA 01915	91-4258-3
12. Center for Human Development, Inc. 332 Bernie Avenue Springfield, MA 01103	91-4153-3
13. YWCA of Western Mass, Inc. 120 Maple Street Springfield, MA 01103	92-4302-3
14. New North Citizens Council, Inc. 2383 Main Street Springfield, MA 01107-1999	92-4287-3
15. Lynn Youth Resource Bureau 19 Sutton Street Lynn, MA 01901	92-4266-3
16. Middlesex County Correctional Services P.O. Box 97 East Cambridge, MA 02141	92-4310-3
17. Tri-County Youth Programs, Inc. 320 Riverside Drive Northampton, MA 01060	91-4193-3
18. Cape Cod Alcoholism Intervention Rehab Unit 200 Terhuen Drive Falmouth, MA 02540	92-4316-3
19. Gardner-Athol Area Mental Health Association, Inc. 208 Coleman Street Extension Gardner, MA	92-4314-3
20. Berkshire Center for Families & Children, Inc. 480 West Street Pittsfield, MA 01201	92-4312-3

APPENDIX A (Continued)**Audit Sites Visited****Service Providers:****Report Numbers:**

- | | |
|--|-----------|
| 21. Gardner - Athol Area Mental Health Association
Transit, Inc.
208 Coleman Street Extension
P.O. Box 526
Gardner, MA 01440 | 92-4318-1 |
| 22. Franklin/Hampshire Community Mental
Health Center, Inc.
17 New South Street
Northhampton, MA 01060 | 91-4165-3 |
| 23. Community Connections, Inc.
Fiddlers Green
710A Main Street
Yarmouthport, MA 02675 | 92-4313-3 |
| 24. Road to Responsibility, Inc.
83 Enterprise Drive
Marshfield, MA | 92-4317-3 |
| 25. Cape Cod and Islands BSA
247 Willow Street
Yarmouthport, MA 02675 | 93-4023-3 |
| 26. Greater Boston Rehabilitation Services, Inc.
450 Arsenal Street
Watertown, MA 02172 | 93-4320-3 |
| 27. Hillside Resource & Management Corporation, Inc.
186 Lincoln Street, Room 904
Boston, MA 02111 | 93-4321-3 |
| 28. Nonotuck Resource Associates, Inc.
17 New South Street
Northampton, MA 01060 | 93-4326-3 |
| 29. Meriden Associates for Programs and Resources, Inc.
62 Federal Street
Greenfield, MA 01301 | 93-4328-3 |
| 30. Greater Lynn Mental Health and Retardation
Association, Inc.
37 Friend Street
Lynn, MA 01903 | 93-4330-3 |
| 31. Human Service Options, Inc.
35 Braintree Hill Park
Braintree, MA 02184 | 93-4331-3 |

APPENDIX A (Continued)**Audit Sites Visited****Service Providers:****Report Numbers:**

- | | |
|--|-------------|
| 32. Gandara Mental Health Center
2155 Main Street
Springfield, MA 01104 | 93-4329-3 |
| 33. Southeastern Regional Vendor
Educational & Support Services, Inc./
Day & Residential Service Options, Inc.
4 Evergreen Street
Hopedale, MA 01747 | * 88-6009-9 |
| 34. Puerto Rican Veterans Association
of Massachusetts, Inc.
2595 Main Street
Springfield, MA 01107 | 93-4332-3 |
| 35. Behavior Research, Inc.
240 Laban Street
Providence, RI 02909 | 94-4333-3 |
| 36. The Institute for Development
Disabilities, Inc., d/b/a The
Crystal Springs School
38 Narrows Road
Assonet, MA 02702 | 94-4335-3 |
| 37. South Shore Community Action Council, Inc.
P.O. Box 3610
265 South Meadow Road
Plymouth, MA 02360 | 92-6007-9 |
| 38. Community Teamwork, Inc.
167 Dutton Street
Lowell, MA 01852 | 91-6012-9 |
| 39. WORK, Inc.
3 Arlington Street
No. Quincy, MA 02171 | * 92-6005-9 |
| 40. New Medico, Inc.
P.O. Box 28
Lynn, MA 01903-0028 | 92-6004-9 |

*A special review was conducted at these providers to investigate allegations of misappropriated and/or misused state funds.

APPENDIX B

State Agencies That Purchase Social Services*

1. Chelsea Soldiers' Home
91 Crest Avenue
Chelsea, MA 02150
2. Department of Mental Health
25 Staniford Street
Boston, MA 02114
3. Department of Correction
100 Cambridge Street, 22nd Floor
Boston, MA 02202
4. Department of Public Health
150 Tremont Street
Boston, MA 02111
5. Department of Youth Services
27-43 Wornwood Street
Boston, MA 02210
6. Holyoke Soldiers' Home
110 Cherry Street
Holyoke, MA 01040
7. Mass. Comm. Deaf & Hard of Hearing
Suite 600
600 Washington Street
Boston, MA 02111
8. Office for Children
One Ashburton Place, 11th Floor
Boston, MA 02108
9. Parole Board
Fort Point Place, Suite 300
27-43 Wornwood Street
Boston, MA 02210
10. Department of Public Welfare
600 Washington Street
Boston, MA 02111
11. Disabled Persons Protection Comm.
2 Boylston Street
Boston, MA 02116
12. Department of Mental Retardation
160 North Washington Street
Boston, MA 02114

APPENDIX B (Continued)**State Agencies That Purchase Social Services***

13. Department of Education
Bureau of Institutional Schools
c/o School Office, MA Hospital School
3 Randolph Street
Canton, MA 02021
14. Department of Social Services
24 Farnsworth Street
Boston, MA 02210
15. Executive Office of Elder Affairs
1 Ashburton Place, Room 517
Boston, MA 02108
16. Mass. Commission for the Blind
88 Kingston Street
Boston, MA 02111
17. Mass. Rehabilitation Commission
27-43 Wormwood Street
Boston, MA 02210
18. Office for Refugees & Immigrants
2 Boylston Street, 3rd Floor
Boston, MA 02116
19. Office of Veterans' Services
100 Cambridge Street, 11th Floor
Boston, MA 02202

*Extracted from Appendix 5 of DPS's Purchase-of-Service System User Handbook.

APPENDIX C

Description of Audited State Agencies²⁰

Department of Youth Services: The Department of Youth Services (DYS) was created by Chapter 838 of the Acts of 1969. This statute abolished the former Board and the Division of Youth Services and established a separate agency, DHS, under the supervision of the Executive Office of Human Services. This new department, which became the juvenile correctional agency for the Commonwealth governed by MGL, Chapters 18A, 119, and 120, serves a dual mandate of public protection and juvenile rehabilitation for offenders between the ages of seven and 18.

DYS's organizational structure includes a central administrative office and five regional offices. The central office provides overall administrative direction and support and is divided into five bureaus:

Community Services, which oversees regional offices and all community-based services.

Facility Operations, which oversees all secure facilities, shelter care units, the forestry camp, and the classification panel.

Administrative Services, which oversees the budget, fiscal operations, contracting, and personnel.

Support Services, which oversees educational, health, food, and vocational services.

Research, Planning and Systems, which oversees all research client tracking, population analysis, and program utilization.

The five regional offices manage the cases of youths committed to DHS who fall within its geographical boundaries and include:

1. Western Region - Springfield, MA
2. Central Region - West Boylston, MA
3. Northeast Region - Wilmington, MA
4. Southeast Region - Taunton, MA
5. Metropolitan Boston - Boston, MA

DYS serves a population of approximately 1,600 youths who are committed its long-term care and custody. As of December 31, 1993, 92% of these youths were male, and 8% were female. DHS also provides a detention service to the courts that includes the daily placement of approximately 150 youths awaiting court dispositions. The average DHS youth is 16 years old and is a chronic truant or school drop out. Of the committed population, as of December 31, 1993, 54% had been adjudicated delinquent for property-related crimes, 38% for person-related crimes, and 8% for drug crimes.

 20 The POS expenditures identified in this appendix are total POS-related expenditures provided to us by agency officials and/or the Office of the State Comptroller. The portion of these total fiscal year 1993 expenditures that were in the object codes subject to our review were as follows: DHS = \$34,625,350; DSS = \$211,793,015; DOC = \$41,988,074; DMR = \$323,370,050; and DMR = \$269,480,905.

APPENDIX C (Continued)**Description of Audited State Agencies**

DYS operates a predominantly community-based system of care that is geared towards the gradual integration into the community on or before a youth's 18th birthday. The programs and services provided by DYS include:

- o Secure Treatment, which provides long-term residential placements for youths committed on serious charges that warrant placement in a locked facility.
- o Secure Detention which provides short-term residential placements in a locked facility for youths awaiting trial on serious charges.
- o Shelter Care, which provides short-term residential programs for youths awaiting trial on charges that do not warrant secure confinement, or for youths awaiting placement in programs for nonviolent crimes.
- o Transitional Management Programs, which provide short-term assessment for newly committed youths on charges not requiring secure confinement or for youths in transition to or from the community.
- o Group Homes, which provide placements for youths who are committed to DYS for nonviolent offenses and who can be placed in the community with no risk to the public.
- o Foster Care, which provides ease in private homes for first-time or low-risk offenders who would benefit from a supportive family setting.
- o Homeward Board Program, which is a short-term placement that is designed to build self-esteem through rigorous physical challenges in the outdoors.
- o Outreach and Tracking, which provides supervision of newly committed or low-risk offenders in the community or youths leaving long-term secure programs and gradually being reintegrated into the community.

In addition, DYS has a wide range of medical, clinical, and educational services available through both private providers and other state agencies.

DYS provides the majority of its programs through provider contracts with private social services. For fiscal year 1992, DYS expended approximately \$54 million in funding, of which approximately \$33 million (61%) was expended on POS-related activities. In fiscal year 1993, DYS expended approximately \$56 million, of which 61%, or approximately \$34 million, was for POS services.

Department of Social Services: The Massachusetts Department of Social Services (DSS) was created by Chapter 552 of the Acts of 1978 and MGL Chapter 18B for the purpose of establishing a comprehensive program of social services (including social, legal, health, rehabilitation, employment, or other services) to meet the needs of various groups or individuals, including families, children, unmarried parents, the elderly and other adults, the disabled, and the handicapped.

APPENDIX C (Continued)**Description of Audited State Agencies**

DSS uses its own social work staff, as well as those of contracted service providers to provide its clients with the services mandated by MGL Chapter 18B. DSS's clinicians work out of the department's 26 area offices and provide case management, counseling, and referral services to families that meet the DSS's financial-eligibility requirements. In addition, area office staff are responsible for awarding contracts to service providers, who provide the required services to clients, and for monitoring the activities of these service providers to ensure that they comply with the conditions of their DSS contracts and departmental regulations.

MGL Chapter 18B, Section 2, requires DSS to provide the following services:

1. Casework or counseling including social services to families foster families, or individuals;
2. Protective services for children, unmarried mothers, the aging and other adults;
3. Legal services for families, children or individuals as they relate to social problems;
4. Foster family care and specialized foster family care for children, the aging, the disabled and the handicapped;
5. Adoption services;
6. Homemaker services;
7. Day care facilities and services for children, the aging, the disabled and the handicapped;
8. Residential care for children with special needs or aging persons not suited to foster family care, or specialized foster family care;
9. Informal education and group activities as needed for families, children, the aging, the disabled and the handicapped;
10. Training in parenthood and home management for parents, foster parents, and prospective parents;
11. Social services for newcomers to an area or community to assist in adjustment to a new environment and new resources;
12. Camping services;
13. Family services intended to prevent the need for foster care and services to children in foster care;
14. Temporary residential programs providing counseling and supporting assistance for women in transition and their children who because of domestic violence, homelessness, or other situations require temporary shelter and assistance;
15. Information and referral services; and
16. Provide social services for families and individuals in emergency and transitional housing.

APPENDIX C (Continued)**Description of Audited Site Agencies**

During fiscal year 1993, DSS's client population was approximately 30,000. This included 2,000 children in foster care, 1,800 children in provider-operated community residences, and 5,000 parents receiving counseling supportive services. In addition, DSS funds approximately 40,000 day care slots.

During fiscal year 1992, DSS expended approximately \$423 million in funding, of which approximately \$316 was expended on POS-related activities. During fiscal year 1993, DYS expended approximately \$422 million in funding, of which approximately \$313 million was expended on POS-related services.

In March 1992, the State Comptroller placed DSS in fiscal receivership. This resulted from DSS filing misleading reports, overspending program budgets, and misusing appropriated funds in using fiscal year 1992 funds to pay fiscal year 1991 provider invoices. This receivership was ended on March 22, 1993 after DSS had improved its voucher-processing system.

Department of Corrections: The Department of Corrections (DOC), under the auspices of the Executive Office of Public Safety, is charged with the detention of those committed to the custody and control of the Commonwealth of Massachusetts. MGL Chapter 124 identifies the powers and duties of the Department of Correction, while Section 1 of this legislation specifically outlines the Commissioner of Correction's role in the administration of DOC which includes the following:

- o Designate, establish, maintain, and administer such state correctional facilities as he deems necessary.
- o Establish and enforce standards for all correctional facilities.
- o Establish, maintain and administer programs of rehabilitation, including but not limited to education, training and employment, of persons committed to the custody of the Department, designated as far as practicable to prepare and assist each such person to assume the responsibilities and exercise the rights of a citizen of the Commonwealth.
- o Determine at the time of commitment, and from time to time thereafter, the custody requirements and program needs of each person committed to the custody of the department, and assign or transfer such persons to appropriate facilities and programs.
- o Make and enter any contracts and agreements necessary or incidental to the performance of the duties and execution of the powers of the department, including contracts to render services to committed offenders.
- o Make and promulgate necessary rules and regulations incident to the exercise of his powers and the performance of his duties.

Based on these legislative requirements, DOC has established an operational approach of protecting society from criminal offenders, while providing an opportunity for inmates to rehabilitate themselves in order to be better prepared for their eventual reintegration into society. At each level of security, DOC seeks to operate clean, safe, and humane institutions, manageable in size, with an appropriate range of services that recognize the individual needs of offenders.

APPENDIX C (Continued)

Description of Audited State Agencies

During fiscal years 1992 and 1993, the Department of Correction operated 24 facilities and was responsible for an inmate population of approximately 9,500. Nineteen of these facilities housed state inmates, while the remainder held county inmates or civil, criminal, or self-committed patients.

The Commonwealth's major prison complexes are:

- o Bridgewater: Old Colony Correction Center (OCCC), Southeastern Correctional Center (SECC), Addiction Center, Bridgewater State Hospital, and the Treatment Center for Sexually Dangerous Persons.
- o Framingham: Massachusetts Correctional Institution (MCI) Framingham, Hadder Cottage, and South Middlesex Pre-Release.
- o Cedar Junction/Norfolk: MCI Cedar Junction, MCI Norfolk, Bay State Pre-Release, and Pondville Correctional Center.
- o Shirley: MCI Shirley - Medium Security and MCI Shirley - Minimum Security.
- o Concord: MCI Concord and Northeastern Correctional Center at Concord.

In addition, DOC operates several smaller medium-security and security pre-release centers. During fiscal year 1992, DOC expended approximately \$279 million in funding, of which \$41 million (15%) was expended on POS-related activities. During fiscal year 1993, DOC expended approximately \$287 million in funding, of which approximately \$42 million was expended on POS-related activities.

The following table identifies the number and types of services that DOC contracted for during fiscal years 1992 and 1993:

<u>Type of Service</u>	<u>Number of Contracts</u>	
	<u>1992</u>	<u>1993</u>
Substance Abuse Program	8	8
Half Way Houses (Pre-Release Centers)	3	3
Medical and Mental Health	4	1
Employment Referral/Counseling	7	-*
Prisoner Transfer (Federal)	1	1
County House Operations	<u>6</u>	<u>-*</u>
	<u>29</u>	<u>13</u>

* These programs services were reclassified and placed into different subsidiary accounts.

Department of Mental Retardation: The Massachusetts Department of Mental Retardation (DMR) was created by Chapter 599 of the Acts of 1986. This act provided for the transfer of responsibility for services for mentally retarded persons from the Department of Mental Health. The newly created agency became operational during fiscal year 1987 within EOHHS.

APPENDIX C (Continued)**Description of Audited State Agencies**

According to information published by DMR, the agency's mission is to create, in cooperation with others, innovative and genuine opportunities for individuals with mental retardation to participate fully and meaningfully in their communities as valued members.

DMR provides a variety of services that offer varying degrees of support for people with mental retardation and their families. These services include residential programs; education and training services; day and work preparation services; supported employment; family support services; transportation; and medical and psychiatric services.

DMR manages the provision of these services through a decentralized organizational structure with a central office, five regional offices, 27 area offices, and seven state-operated facilities, as detailed in the following table.

Department of Mental Retardation
Area Office Locations

	<u>Geographic Region/ Location</u>	<u>Number of Area Offices</u>	<u>State-Operated Facilities</u>
I.	Western Massachusetts - Springfield	4	Monson Development Center
II.	Central Massachusetts - Shrewsbury	6	Templeton Development Center Glavin Regional Center
III.	Northeastern Massachusetts - Hawthorne	5	Hogan/Berry
IV.	Southeastern Massachusetts - Carver*	7	Denver State School Wrentham State School
V.	Metro Boston - Boston	<u>5</u> <u>27</u>	Fernald State School

*Due to budgetary and other considerations, in November 1990, DMR closed its Regional Office in Region IV and reallocated the management of POS programs to its other geographic regions, as follows: 40% to Region II, 40% to Region III, and 20% to Region V.

Each regional office is headed by a director whom the DMR Commissioner has designated to be the awarding authority for all contracts within that region. Each area office within a region is responsible for maintaining individual service plans (ISP) for each client and for developing a list of individuals waiting to receive services. Area office staff are responsible for monitoring all program services and activities.

APPENDIX C (Continued)**Description of Audited State Agencies**

Approximately 84% of DMR's client population, which as of December 31, 1993 totaled approximately 21,000 individuals, received their needed services from a private service provider who is under a contract with DMR to provide these services.

During fiscal years 1992 and 1993, DMR expended approximately \$603 million and \$652 million in funding, respectively, of which \$297 million (49%) and \$325 million (50%), respectively, was expended on POS-related services. During fiscal year 1992, these funds were expended through 1,565 POS contracts to a total of 357 human service providers. During fiscal year 1993, DMR expended these funds through 1,668 contracts with 375 human service providers.

Department of Mental Health: The Department of Mental Health (DMH) was established by MGL Chapter 19, Section 1, for the purpose of taking cognizance of all matters affecting the mental health of the citizens of the Commonwealth and the welfare of the mentally retarded. This statute delegated to DMH the supervision and control of all public and private facilities for mentally ill and mentally retarded persons, except for those for those facilities that are statutorily under the control of another state agency.

During fiscal year 1986, the state Legislature enacted Chapter 599 of the Acts of 1986, which formally created two separate departments DMH and DMR from DMH. Subsequent to this split, DMH's mission changed for providing services to mentally ill and/or retarded individuals to providing services to citizens with long-term or serious mental illness, early and ongoing treatment for mental illness, and research into the causes of mental illness. These services include acute and ongoing clinical treatment, emergency crisis intervention, psychiatric assessment/evaluation, counseling, case management, vocational and employment services, residential programs, and specialized and forensic mental health services.

According to its current mission statement, DMH is developing a system of public managed care. Public managed care is based on a statewide system of comprehensive community support systems that is designed to provide consumers with access to an array of community-based, coordinated, high-quality services that promote independence and recovery and prevent unnecessary hospitalization. The goal is to provide appropriate clinical care, supportive services, and a range of housing and rehabilitation opportunities, as well as coordinated interagency services and family and school supports for children and adolescents, that are based on each individual's clinical need and preferences for service. The vision of public managed care is to eliminate the stigma of mental illness and allow all mental health consumers the opportunity to develop a sense of personal achievement, control, and empowerment.

DMH manages the provision of its services through a decentralized organizational structure, consisting of a central office that has a division for forensic mental health services, a division for child/adolescent services, and seven area offices. DMH's central office is responsible

APPENDIX C (Continued)

Description of Audited State Agencies

for the overall administration of the DMH's service delivery system and provides various administrative and support services to area offices. Each area office has an area director, who is responsible for managing the delivery of services (e.g., awarding contracts) in their respective service delivery areas. The location of each of DMH's area offices are as follows:

Department of Mental Health
Area Office Locations

	<u>Geographic Region/ Location</u>	<u>Number of Area Offices</u>	<u>State-Operated Facilities</u>
I.	Western Massachusetts Northampton	7	None
II.	Central Massachusetts Worcester	4	Worcester State Hospital
III.	North East - Tewksbury	6	Tewksbury State Hospital - "Hawthorne Units" Solomon Mental Health Center
IV.	Metro-West Westborough	2	Westborough State Hospital
V.	Metro-South Medfield	2	Medfield State Hospital Quincy Mental Health Center
VI.	Southeastern Massachusetts Brockton	6	Taunton State Hospital Pocasset Mental Health Center Brockton Multi Serv. Center Corrigan Mental Health Center
VII.	Metro-Boston Boston	1	Bay Cove Community Mental Health Center Dr. Solomon Carter Fuller Erich Lindemann MHC Mass. Mental Health Center Cambridge/Somerville Center
		<u>28</u>	

The majority of program services provided by DMH are purchased through the state's POS System. During fiscal years 1992 and 1993, DMH expended approximately \$428 million and \$666 million, respectively, of which \$228 million (53%) and \$271 million (41%), respectively, was spent on POS-related activities. According to DMH's management control system POS directory, during fiscal year 1993, DMH awarded a total of 1,001 service contracts to 225 contracted social service providers. During this fiscal year, DMH officials told us that they provided services to approximately 100,000 clients.

APPENDIX D

Description of Expenditures and Object Codes in the "MM"
Subsidiary Account that were Subject to Our Review

Subsidiary MM Purchased Client Human Services and Programs, and Non-Human Services Programs: This subsidiary includes expenditures for purchased services including social, special educational, health, medical, mental health, retardation, rehabilitative, habilitative, and elder services to clients, residents, students, etc., by individuals or organizations and other state departments including client transportation. Included are expenditures for social services and medical care to inmates, patients, and clients rendered by individuals other than employees of the procuring department. Also included are certain purchased services, such as vendor staff training or information and referral programs, and programs that may not involve direct client care but instead support or supplement direct client services. Also included are programs that facilitate the creation and retention of affordable housing (see M10). This subsidiary also includes expenditures for both human service and non-human-service-related programs funded through Cooperative Funding Agreements (see M05 and M10). For benefit payments directly to or on behalf of recipients, see subsidiary RR. An important distinction exists between object codes because of tax reporting requirements for individuals and corporations providing medical and health-care-related services.

PROGRAM SERVICES: (Programs or Services Rendered by Organizations)

M03 Contracts - Non-Medical: Payments pursuant to agreements to purchase specified programs (excluding medical and health care, see MM3) on behalf of specifically identified clients or a specific target group. Limited to services with no health care components, such as transportation of clients and payments to "Chapter 766" approved private schools rendering special educational services. Also includes contracts for planned emergency non-medical services. Excludes unplanned emergency services (see M08).

MM3 Contracts - Medical or Health Care Related Services: Payments pursuant to agreements to purchase programs with medical or health-care-related components on behalf of specifically identified clients or a specific target group. Also includes contracts for planned emergency medical or health care related services. For unplanned emergency services, see M08.

M04 Reserved

M05 Human-Service-Related Cooperative Funding Agreement: Payments pursuant to agreements providing financial assistance to support the availability of human services to the general public or a segment of the general public or to support the operations of community service organizations. These agreements are the result of an application process or competitive procurement. For agreements for specified services on behalf of specifically identified clients or a specific target group, refer to M03 or MM3. Excludes non-human-service programs (see M10).

M06 Formula Procurements: Payments for which the recipient organization or the award obligation amount is not subject to the spending department's discretion, as in the case of an appropriation earmarked for specifically identified organizations.

M08 Emergency Procurement: Payments for non-planned emergency services (human services). There are limitations on duration and cost of services beyond which a waiver must be requested.

* These descriptions were extracted from the Expenditure Classification Handbook (Publication # 17088-99-600-4-92-C.R) issued by the Office of the State Comptroller, April 1992, for fiscal year 1993.

APPENDIX E**EOHHS's Purchase of Service Task Force
Draft Report Recommendations****A. Short-Term Recommendations:**

1. Require all corporations to fully disclose any "related relationships" that exist or may appear to exist within their organization and require a signed certification statement of compliance as a pre-requisite to recontracting for FY 94 . . . (this is an expansion of current regulations).
2. Require all members of a corporation's senior management and governing Board of Directors to fully disclose all financial interests and require a signed certification statement of compliance as a pre-requisite to recontracting for FY '94 (this is an expansion of current regulations).
3. Require all corporations contracting with a health and human services agency to perform and file a standard self-evaluation. Satisfactory performance of this evaluation should be a condition for continued business with the Commonwealth. The evaluation should be conducted with the participation of a designated representative of the provider's Principal Purchasing Agency (PPA). In addition, a random review will be performed for a significant number of these self evaluations to ensure accuracy. . . .
4. Develop special contract provisions for designated "Critical Services" so that, in the event that the contracts for these "Critical Services" are terminated prematurely by either party, the provider is bound to transfer the use of the associated facility and specialized equipment at a fair market rate to a replacement provider for at least twenty-four months.
5. Initiate a comprehensive review of the pre-qualification submissions of the 100 providers receiving the greatest amount of HHS funding (in conjunction with number seven to follow) both to identify situations requiring further action and produce baseline information for development of long-term recommendations for reform.
6. Introduce legislation providing for receivership of health and human services agencies, whereby, in circumstances deemed critical by HHS, HHS can require/impose changes in governance and executive management of a provider agency.
7. Require each HHS Agency to designate, train, and strictly evaluate a centralized staff to review and monitor mandatory submission materials and identify all "problem" providers for further review.
8. Impanel a Permanent Interagency/Interdisciplinary Review Committee to immediately resolve all "Conditionally Pre-qualified" provider statuses and to investigate any "problem" providers identified, either internal or external to the Secretariat. The panel should be made up of consumers, specialist in program operations, clinical management, quality assurance, contract auditing, and financial analysis. This committee should be empowered to:
 - a. Establish minimum monitoring/oversight standards and expectations for all HHS agencies;
 - b. Establish standards and processes for the identification and procurement of "best qualified" providers to, on an as needed basis, deliver interim management services or assume the "emergency take-over" of contract services that are to be terminated;

APPENDIX E (Continued)**EOHHS's Purchase of Service Task Force
Draft Report Recommendations**

- c. If indicated, as part of a corrective action plan for deficient providers, require discipline and/or dismissal or removal of any and all members of a corporation's senior management and governing Board of Directors as a condition for continued business with the Commonwealth;
 - d. If indicated, as part of corrective action plan for deficient providers, require a corporation's senior management and governing Board of Directors to discontinue any particular activity cited as unacceptable by the committee as a condition for continued business with the Commonwealth;
 - e. Ultimately require termination, as appropriate, of state funding to a provider agency as a result of unsatisfactory compliance with corrective action plans; and
 - f. Refer any finding or provider misfeasance to the appropriate level of criminal investigation.
9. Promulgate a statement of basic standards and principles and require all providers to submit a certification of compliance as a pre-requisite to recontracting for FY '94.
 10. Conduct mandatory training sessions for all EOHHS agencies' and provider agencies' senior managers regarding Conflict of Interest laws and Executive Order 346, encouraging early supervisory dialogues about potential conflicts and steps necessary to avoid them to maintain optimal functioning of daily operations.
 11. Require all corporations contracting with a health and human services agency to file a copy of their annual Public Charities Report with their Principal Purchasing Agency (where applicable). Satisfactory performance of this evaluation should be a condition for continued business with the Commonwealth.
 12. All providers must submit a certification statement that at least two members of their board of directors are consumers of HHS services as a condition of doing business with any HHS agency.
 13. Introduce regulations that limit the Commonwealth's reimbursement to private organizations for management salaries to the annual wage paid to major agency commissioners, or \$78,000.

B. Long-Term Recommendations

1. Charge the aforementioned Interagency/Interdisciplinary Review Committee to immediately initiate a review of provider agencies to develop recommendations on:
 - a. Consolidation of all administrative contracting functions to a single entity across state agencies promoting economics of scale, concentrated audit capacity, and uniformity of data collection and reporting capabilities;
 - b. Establishment of a uniform POS contract reimbursement methodology that is based upon client enrollment to insure a timely and accurate "clients in service" data base;

APPENDIX E (Continued)**EOHHS's Purchase of Service Task Force**
Draft Report Recommendations

- c. Provider standards (for example, executive compensation and increases, as compared to direct care worker compensation; ideal financial profile for provider agencies; disclosure of and appropriate instances of related party transactions);
 - d. Regulations that should be strengthened to provide consequences for failure to comply with standards;
 - e. Trade-offs between a provider system composed of fewer/larger providers versus the current system;
 - f. Outcome/performance-based contracting;
 - g. Capitated contracting;
 - h. Capitalization strategies for providers;
 - i. Comprehensive system for review of providers;
 - j. Licensing/accreditation of all HHS providers;
 - k. Technical assistance and special support for minority and women-governed providers;
 - l. Standards for the routine rebidding of audit services and the prequalification of CPA firms contracted to perform provider audits; and
 - m. Expansion of DMH Office of Competitive Bidding to all EOHHS agencies, providing a forum for state employee competition on all private contracts and to ensure rigorous "make vs. buy" analysis.
2. Upon completion of the program and provider evaluation processes, the annual rebid process/five year bid cycle should be eliminated. In lieu of the five-year bid cycle, contracts would remain with a particular provider until such time as the state determines through the evaluation process that services/outcomes and/or providers are unsatisfactory, or at such time that the purchasing agency chooses to rebid the services.

APPENDIX F

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4. **Purchase of Service Reform: Final report** issued by the Office of Purchased Services January 31, 1990, (publication #16, 174-25-3000-1-90-C.R.)
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7. **An Agenda for The Reform of The Purchase of Service System in Massachusetts.** Issued by the Massachusetts Council of Human Service Providers, November 1983
8. **Purchase of Service: Protecting the Promise of Community Based Care.** Issued by the Senate Committee on Ways and Means, April 1986
9. **A survey of Financial Management Problems among Human Service Providers in Massachusetts.** Issued by the Massachusetts Council of Human Service Providers, 1991
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11. "Interim Report" on the POS system. Issued by the Office of Purchased Services, December 30, 1988.
12. **Does Privatization Serve the Public Interest?** An Article by John B. Goodman and Gary Loveman, Harvard Business Review, November - December 1991.
13. **Privitization in Massachusetts Getting Results.** Issued by EOAF November 1, 1993.
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APPENDIX F (Continued)**Bibliography of Referenced Publications**

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22. Component Pricing, An Impact Statement. Issued by the Division of Purchased Services, 1991.
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